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IN THE

Supreme Court of the United States

OCTOBER TERM, 1928.

No. 131.

THE ST. LOUIS AND O'FALLON RAILWAY COMPANY AND MANUFACTURERS' RAILWAY COMPANY,

Appellants,

vs.

THE UNITED STATES OF AMERICA AND THE INTERSTATE COMMERCE COMMISSION,

Appellees.

No. 132.

THE UNITED STATES OF AMERICA, AND THE INTERSTATE COMMERCE COMMISSION,

Appellants,

vs.

THE ST. LOUIS AND O'FALLON RAILWAY COMPANY AND MANUFACTURERS' RAILWAY COMPANY,

Appellees.

BRIEF FOR THE UNITED STATES

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI.

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IN THE

Supreme Court of the United States

THE ST. LOUIS AND O'FALLON RAILWAY COMPANY AND MANUFACTURERS' RAILWAY COMPANY, *Appellants,* vs. THE UNITED STATES OF AMERICA AND THE INTERSTATE COMMERCE COMMISSION, *Appellees.*	No. 131.
THE UNITED STATES OF AMERICA AND THE INTERSTATE COMMERCE COMMISSION, *Appellants,* vs. THE ST. LOUIS AND O'FALLON RAILWAY COMPANY AND MANUFACTURERS' RAILWAY COMPANY, *Appellees.*	No. 132.

October Term, 1928.

BRIEF FOR THE UNITED STATES.

No. 131 is an appeal taken by the two Railway Companies above named from a decree of the United States District Court for the Eastern District of Missouri, entered upon a Petition by the two Railway Companies mentioned, to enjoin the enforcement of an order of the Interstate Commerce Commission directing the payment of excess net railway operating income received by the first named Railway Company during ten months of the year 1920, and the years 1921, 1922 and 1923, pursuant to Section 15a of the Interstate Commerce Act, such decree

being entered after hearing before three judges, pursuant to the provisions of the Judicial Code, Sections 207-208 and U. S. Code, Title 28, Section 47. The decree modified the order of the Commission by striking out a provision for interest but otherwise dismissed the petition.

No. 132 is an appeal by the United States and the Interstate Commerce Commission, from so much of the said order of the District Court as cancelled and annulled that part of the order of the Interstate Commerce Commission which directed payment of interest by the St. Louis and O'Fallon Railway for periods of time prior to May 17, 1927.

The Report of the Commission written by Commissioner Meyer is printed at pages 37-83 of the Record; the Order at pages 104-5.

Two opinions were rendered in the District Court, one by Stone, Circuit Judge, which was concurred in by Van Valkenburgh, Circuit Judge, and is printed in the Record at pages 125-140. An opinion concurring in the decision, but upon somewhat different grounds from those in the majority opinion, was filed by Faris, District Judge, and is printed in the Record at pages 140-148. The opinions also are reported in 22 Fed. (2nd), 980.

Jurisdiction of This Court.

We accept the argument of Appellants on this point (Brief, pp. 5-15), except insofar as they contend that to interpret the order of the Commission as an order for the payment of money is

> "• • • to give it an interpretation fatal to the authority of the Commission to make and enforce it" (Brief, pp. 13-14).

In support of this proposition, Appellants refer to Section 13, paragraph (2), of the Interstate Commerce Act. They make no mention of or reference to Section 12, paragraph (1). Section 13 deals with the subject of complaints by persons or corporations concerning acts done by common carriers subject to the provisions of the Act in contravention thereof, and similar complaints by railroad commissioners of any State or territory, giving at the same time power to the Commission itself to institute inquiry into those subjects, and conferring upon the Commission the power to proceed with such an inquiry.

> "* * * including the power to make and enforce any order or orders in the case, or relating to the matter or thing concerning which the inquiry is had excepting orders for the payment of money."

The whole scope of this Section has reference to acts by common carriers subject to the provisions of the Act which are in contravention of its terms. Section 12, on the other hand, is a broad grant of power to the Commission, not only to inquire into the management of the business of common carriers subject to the provisions of the Act, and to keep itself informed as to the manner and method in which it is conducted, but also

> "* * * the Commission is hereby authorized and required to execute and enforce the provisions of this Act; and, upon the request of the Commission, it shall be the duty of any district attorney of the United States to whom the Commission may apply to institute in the proper court and to prosecute under the direction of the Attorney General of the United States all necessary proceedings for the enforcement of the provisions of this Act, and for the punishment of all violations thereof. * * *"

The power to make orders for the payment of money under this section is not withheld.

Appellants say:

> "In proceeding to investigate the excess income of appellants, and to make the order involved in this case, the Commission evidently proceeded upon the theory that it had the power to do so under Section 13" (Brief, p. 14).

This observation seems irrelevant, as it is quite evident that the order was fully justified under Section 12 which we have just quoted.

The order is not merely one for the payment of money. It is an order upon an accounting which finds that the O'Fallon holds certain moneys as trustee for the United States, and directs them to be paid to the Interstate Commerce Commission, and also finds that the O'Fallon holds an amount of excess net railway operating income which is required by the statute to be placed in a reserve fund established and maintained by the O'Fallon, and, therefore, directs that it be so disposed of. This order, therefore, is more than a mere "order for the payment of money". If it be treated as two orders, so much thereof as directs the O'Fallon to hold in its reserve fund an amount of income in each of the years mentioned, certainly is not an order for the payment of money, and is free from the difficulties respecting the jurisdiction of this Court on appeal attendant upon a mere order for the payment of money. Therefore, on all the grounds stated by the Appellants, except the one just noted, the United States agrees with Appellants in the conclusion that this Court has jurisdiction of this appeal.

Question Presented.

The question presented is whether or not the Interstate Commerce Commission proceeded properly and in accordance with law, particularly Section 15a of the Interstate Commerce Act, in ascertaining and determining that the Appellant St. Louis and O'Fallon Railway Company, in the years mentioned in its order, had received a net railway operating income in excess of six per centum of the value of the railway property held for and used by it in the service of transportation, and in ordering that one-half of the same, being held by the said Company as trustee for the United States, pursuant to paragraph (6) of said Section 15a, with interest thereon, be paid over by said Company to the Commission, and in further ordering that the remaining one-half of such excess net railway operating income be placed in a reserve fund, as required by the said paragraph of said section.

There is involved in this question the determination of whether or not the Commission proceeded properly in valuing the railway property held for and used by Appellants in the service of transportation.

There are a number of subsidiary questions, the most important of which is whether or not the two Appellant Railways constitute "a group of carriers" which the Commission should have found "are under common control and management and are operated as a single system," within the meaning of paragraph (6) of Section 15a of said Act.

Statutes Involved.

Section 15a of the Interstate Commerce Act, added to it by the Transportation Act 1920, Section 422 (41 Stats. 456), contains the following provisions:

"(2) In the exercise of its power to prescribe just and reasonable rates the Commission shall initiate, modify, establish or adjust such rates so that carriers as a whole (or as a whole in each of such rate groups or territories as the Commission may from time to time designate) will, under honest, efficient and economical management and reasonable expenditures for maintenance of way, structures and equipment, earn an aggregate annual net railway operating income equal, as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation: *Provided*, That the Commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust or unreasonable, and to prescribe different rates for different sections of the country.

"(3) The Commission shall from time to time determine and make public what percentage of such aggregate property value constitutes a fair return thereon, and such percentage shall be uniform for all rate groups or territories which may be designated by the Commission. In making such determination it shall give due consideration, among other things, to the transportation needs of the country and the necessity (under honest, efficient and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation: *Provided*, That during the two years beginning March 1, 1920, the Commission shall take as such fair return a sum equal to 5½ per centum of such aggregate value, but may, in its discretion, add thereto a sum not exceeding one-half of one per centum of such

aggregate value to make provision in whole or in part for improvements, betterments or equipment, which, according to the accounting system prescribed by the Commission, are chargeable to capital account.

"(4) For the purposes of this section, such aggregate value of the property of the carriers shall be determined by the Commission from time to time and as often as may be necessary. The Commission may utilize the results of its investigation under section 19a of this Act, in so far as deemed by it available, and shall give due consideration to all the elements of value recognized by the law of the land for rate making purposes, and shall give to the property investment account of the carriers only that consideration which under such law it is entitled to in establishing values for rate-making purposes. Whenever pursuant to section 19a of this Act the value of the railway property of any carrier held for and used in the service of transportation has been finally ascertained, the value so ascertained shall be deemed by the Commission to be the value thereof for the purpose of determining such aggregate value.

"(5) Inasmuch as it is impossible (without regulation and control in the interests of the commerce of the United States considered as a whole) to establish uniform rates upon competitive traffic which will adequately sustain all the carriers which are engaged in such traffic and which are indispensable to the communities to which they render the service of transportation, without enabling some of such carriers to receive a net railway operating income substantially and unreasonably in excess of a fair return upon the value of their railway property held for and used in

the service of transportation, it is hereby declared that any carrier which receives such an income so in excess of a fair return, shall hold such part of the excess, as hereinafter prescribed, as trustee for, and shall pay it to, the United States.

"(6) If, under the provisions of this section, any carrier receives for any year a net railway operating income in excess of 6 per centum of the value of the railway property held for and used by it in the service of transportation, one-half of such excess shall be placed in a reserve fund established and maintained by such carrier, and the remaining one-half thereof shall, within the first four months following the close of the period for which such computation is made, be recoverable by and paid to the Commission for the purpose of establishing and maintaining a general railroad contingent fund as hereinafter described. For the purposes of this paragraph the value of the railway property and the net railway operating income of a group of carriers, which the Commission finds are under common control and management and are operated as a single system, shall be computed for the system as a whole irrespective of the separate ownership and accounting returns of the various parts of such system. In the case of any carrier which has accepted the provisions of section 209 of this amendatory Act* the provisions of this paragraph shall not be applicable to the income for any period prior to September 1, 1920. The value of such railway property shall be determined by the Commission in the manner provided in paragraph (4).

"(7) For the purpose of paying dividends or interest on its stocks, bonds or other securities, or rent

*Transportation Act, 1920

for leased roads, a carrier may draw from the reserve fund established and maintained by it under the provisions of this section to the extent that its net railway operating income for any year is less than a sum equal to 6 per centum of the value of the railway property held for and used by it in the service of transportation, determined as provided in paragraph (6); but such fund shall not be drawn upon for any other purpose.

"(8) Such reserve fund need not be accumulated and maintained by any carrier beyond a sum equal to 5 per centum of the value of its railway property determined as herein provided, and when such fund is so accumulated and maintained the portion of its excess income which the carrier is permitted to retain under paragraph (6) may be used by it for any lawful purpose.

"(9) The Commission shall prescribe rules and regulations for the determination and recovery of the excess income payable to it under this section, and may require such security and prescribe such reasonable terms and conditions in connection therewith as it may find necessary. The Commission shall make proper adjustments to provide for the computation of excess income for a portion of a year, and for a year in which a change in the percentage constituting a fair return or in the value of a carrier's railway property becomes effective."

The nine succeeding paragraphs of the Section contain provisions concerning the use of the moneys paid to the Commission pursuant to the foregoing paragraphs.

Section 19a of the said Act, which was added to the Interstate Commerce Act by the Hepburn-Dolliver Act of

1913 (37 Stats., 701), and amended by the Transportation Act of 1920 (41 Stats., 493), and as further amended by the Act of Congress of June 7, 1922 (42 Stats., 624), provides as follows:

"(a) That the Commission shall, as hereinafter provided, investigate, ascertain, and report the value of all the property owned or used by every common carrier subject to the provisions of this Act. To enable the Commission to make such investigation and report, it is authorized to employ such experts and other assistants as may be necessary. The Commission may appoint examiners who shall have power to administer oaths, examine witnesses and take testimony. The Commission shall make an inventory which shall list the property of every common carrier subject to the provisions of this Act in detail, and show the value thereof as hereinafter provided, and shall classify the physical property, as nearly as practicable, in conformity with the classification of expenditures for road and equipment, as prescribed by the Interstate Commerce Commission.

"(b) First. In such investigation said Commission shall ascertain and report in detail as to each piece of property, other than land, owned or used by said common carrier for its purposes as a common carrier, the original cost to date, the cost of reproduction new, the cost of reproduction less depreciation, and an analysis of the methods by which these several costs are obtained, and the reason for their differences, if any. The Commission shall in like manner ascertain and report separately other values, and elements of value, if any, of the property of such common carrier, and an analysis of the methods of valua-

tion employed, and of the reasons for any differences between any such value and each of the foregoing cost values.

* * * * * * * *

"Fourth. In ascertaining the original cost to date of the property of such common carrier the Commission, in addition to such other elements as it may deem necessary, shall investigate and report upon the history and organization of the present and of any previous corporation operating such property; upon any increases or decreases of stocks, bonds, or other securities, in any reorganization; upon moneys received by any such corporation by reason of any issues of stocks, bonds, or other securities; upon the syndicating, banking, and other financial arrangements under which such issues were made and the expense thereof; and upon the net and gross earnings of such corporations; and shall also ascertain and report in such detail as may be determined by the Commission upon the expenditure of all moneys and the purposes for which the same were expended.

* * * * * * * *

"(c) Except as herein otherwise provided, the Commission shall have power to prescribe the method of procedure to be followed in the conduct of the investigation, the form in which the results of the valuation shall be submitted, and the classification of the elements that constitute the ascertained value, and such investigation shall show the value of the property of every common carrier as a whole and separately the value of its property in each of the several States and Territories and the District of Columbia, classified and in detail as herein required.

"(d) Such investigation shall be commenced within sixty days after approval of this Act and shall be prosecuted with diligence and thoroughness, and the result thereof reported to Congress at the beginning of each regular session thereafter until completed.

* * * * * * * *

"(f) Upon the completion of the valuation herein provided for the Commission shall thereafter in like manner keep itself informed of all extensions and improvements or other changes in the condition and value of the property of all common carriers, and shall ascertain the value thereof, and shall from time to time, revise and correct its valuations, showing such revision and correction classified and as a whole and separately in each of the several States and Territories and the District of Columbia, which valuations, both original and corrected, shall be tentative valuations and shall be reported to Congress at the beginning of each regular session."

Paragraphs (h) and (i) require the Commission, when it shall have completed the tentative valuation of the property of any common carrier, to give notice to the carriers involved, to the Attorney General of the United States, the Governor of any State in which the property so valued is located, and such such additional parties the Commission may prescribe, and allow thirty days time for a protest to the Commission. If no protest is filed within that time, the valuation shall become final. If notice of protest is filed, the Commission is to grant a hearing, revise its valuation, and finally fix such valuation.

Paragraph (i) further provides that all final valuations by the Commission and the classification thereof shall be published and shall be *prima facie* evidence of the value

of the property in all proceedings under the Act to regulate commerce as of the date of the fixing thereof, and in all judicial proceedings for the enforcement of the Act to Regulate Commerce, as amended, and in all judicial proceedings brought to enjoin, set aside, annul, or suspend, in whole or in part, any order of the Interstate Commerce Commission.

Paragraph (j) provides as follows:

> "(j) If upon the trial of any action involving a final value fixed by the Commission, evidence shall be introduced regarding such value which is found by the court to be different from that offered upon the hearing before the Commission, or additional thereto and substantially affecting said value, the court, before proceeding to render judgment shall transmit a copy of such evidence to the Commission, and shall stay further proceedings in said action for such time as the court shall determine from the date of such transmission. Upon the receipt of such evidence the Commission shall consider the same and may fix a final value different from the one fixed in the first instance, and may alter, modify, amend or rescind any order which it has made involving said final value, and shall report its action thereon to said court within the time fixed by the court. If the Commission shall alter, modify, or amend its order, such altered, modified, or amended order shall take the place of the original order complained of and judgment shall be rendered thereon as though made by the Commission in the first instance. If the original order shall not be rescinded or changed by the Commission, judgment shall be rendered upon such original order."

Statement.

Pursuant to the requirements of paragraphs (6) and (9) of Section 15a of the Interstate Commerce Act, the Commission, under date of January 16, 1922, issued an order requiring carriers by railroad to report, among other things, for the period from September 1, 1920, to December 31, 1920, in the case of carriers which had accepted the guarantee of Section 209 of the Transportation Act, 1920, and for the period from March 1 to December 31, 1820, in the case of carriers which had not accepted such guarantee, the value of the property used in transportation service by such carriers, and their net railway operating income for such period (Rec., pp. 38, 39, 105). Orders similar in their requirements, with some variation as to detail, were later issued for the years 1921, 1922 and 1923 (Rec., pp. 38 9, 105). In response thereto the Appellant companies respectively filed returns for the period March to December, 1920, both inclusive, and for the years 1921, 1922 and 1923. Neither of these Companies had accepted the guarantee of Section 209. These reports showed value and income for the two carriers separately, and also for their properties combined, the carriers claiming that they should be considered as under common control and management and operated as a single system within the meaning of paragraph (6) of Section 15a. Hearings were given to the carriers by the Commission, for the purpose of affording them opportunity to submit evidence in support of their reports, and for the receipt of any other evidence that might aid the Commission in making the findings required by the statute. The carriers did submit much evidence. Briefs were filed, and counsel heard in oral argument on the questions developed in the record.

On February 15, 1927, the Commission made a Report upon which it entered its Order of the same date, which

referred to and made such report a part thereof (Rec., pp. 104, 105), whereby it found that no amount of excess net railway operating income was received by the Manufacturers during the period covered by the investigation, but that the following designated amounts of excess net railway operating income were received by the O'Fallon for the periods stated, viz.:

Mar. 1 to Dec. 31, 1920, inclusive	$106,755.96
Jan. 1 to Dec. 31, 1921, inclusive	130,205.13
Jan. 1 to Dec. 31, 1922, inclusive	106,391.03
Jan. 1 to Dec. 31, 1923, inclusive	110,409.22

The order further found that under the provisions of paragraph (5) of said Section 15a, one-half of such excess was held by the O'Fallon as Trustee for the United States; that under the provisions of paragraph (6) of said Section, said one-half was recoverable by and payable to the Commission within the first four months following the close of the period for which the computation was made; and that to the extent required by the provisions of paragraphs (6) and (8), the remaining one-half was required to be placed in a reserve fund established and maintained by the O'Fallon. It was therefore ordered that the amounts of excess net railway operating income held by the O'Fallon as Trustee for the United States under the aforesaid provisions be paid to the Commission within ninety days from the date of the order, together with interest thereon as follows:

From May 1, 1921	$53,377.98
From May 1, 1922	65,102.56
From May 1, 1923	53,195.51
From May 1, 1924	55,204.61

It was further ordered, "that the remaining one-half of such excess net railway operating income be placed in a reserve fund, as required by paragraph (6) of said section, as aforesaid" (Rec., pp. 70-71).

The Report was agreed to by a majority of the Commission (Meyer, Esch, Campbell, Lewis, Brainard); Commissioner Eastman wrote an opinion in which Commissioner MacManamy joined, concurring in the result reached by the majority, but taking a somewhat different view of matters discussed in the Report; Commissioners Hall, Aitchison, Woodlock and Taylor separately wrote opinions dissenting from the Report on various grounds.

The carriers thereupon filed a petition in the United States District Court for the Eastern District of Missouri (Eastern Division), by which they attacked the method pursued by the Commission in reaching the conclusions embodied in its report and order, and sought a decree adjudging that the order of the Commission was beyond its lawful authority and void, that it be set aside, annulled and enforcement thereof perpetually enjoined (Rec., pp. 3, 32). The Interstate Commerce Commission and the United States, respectively, answered the petition (Rec., pp. 109, 114). The cause was tried before Circuit Judges Stone and Van Valkenbergh and District Judge Faris, sitting pursuant to the provisions of the Urgent Deficiencies Act of October 22, 1913 (38 Stats., 219), and a final decree was rendered by them December 19, 1927, overruling the objections of the United States, including a motion in its answer to strike out certain paragraphs from the petition which challenged and denied the jurisdiction of the Court to review that part of the Commission's finding and order which found that the petitioners were not a group of carriers under common control and

management and operated as a single system, within the meaning of paragraph (6) of Section 15a; cancelling so much of the order of the Commission as awarded interest for periods of time prior to May 17, 1927; and as to all other relief, denying the prayer of the petition, and dismissing it for want of equity, at the cost of the petitioners (Rec., pp. 148, 149). From this decree the two carriers separately appealed to this Court, as stated above.

Alleged Errors Complained of.

The Appellants contend that the finding of the Commission that, although the O'Fallon and the Manufacturers constituted a group of carriers under common control and management, they were not operated as a single system, within the meaning of the Act, was based upon an erroneous interpretation thereof, and that the District Court erred in so holding.

They challenge the authority of the Commission to initiate and conduct an investigation into the value of the railway properties; dispute the accuracy of their findings of fair value, and the validity of their order requiring payment of the amount of excess net income declared to be held in trust for the United States; challenge the validity of the requirement of the order that one-half of the net excess operating income found for the years in question be placed in a reserve fund; contend that the order of the Commission was void because unsupported by evidence; that the net railway operating income of O'Fallon did not arise under the provisions of Section 15a, and, therefore, there could be no excess; that the findings of the Commission were void as based upon errors of law, and were unsupported by the evidence; allege that the District Court erred in refusing itself to investigate and determine the valuation of the railways, and that in each and every par-

ticular the order of the Commission was unsupported by the law and facts, and should have been held void, and that the Statutory Court, therefore, erred in not granting an injunction to restrain the enforcement of the Commission's order. They also contend that the Court erred in rejecting certain evidence offered by them.

Summary of Argument for the United States.

I. The District Court correctly affirmed the conclusion reached by the Commission that the railways of the Appellant Companies did not constitute "a group of carriers under common control and management and operated as a single system," within the meaning of the statute.

II. The District Court rightly refused to enter upon a trial *de novo* of the question of valuation.

III. The Commission, in finding the value of the property of the O'Fallon held for and used by it in the service of transportation, proceeded in precise conformity with the statute. It gave due consideration to all the elements of value recognized by the law of the land for rate-making purposes," and gave "to the property investment account of the carriers only that consideration which under such law it is entitled to in establishing values for rate-making purposes."

IV. The true basis for the determination of public utility valuation was laid down in the case of *Smyth* v. *Ames*, 169 U. S., 462, which is still the law. The decision in that case sets up, not a formula, but a standard, holding that neither reproduction cost nor original cost is alone a criterion of value, or to be given dominant consideration, but that the rate-making body must take

all elements and measures of value into consideration, and analyze and ascribe to each its proper weight, in the light of the evidence of the case.

V. The Commission had a broad discretion in weighing the various elements of value in evidence before it, and in reaching a conclusion based thereon. This discretion will not be reviewed by the courts, and the order made by the Commission in the exercise of such discretion is not invalid as made without due process.

VI. The action of the Commission in rejecting the spot cost of reproduction as the sole basis of valuation in the recapture years was in conformity with the intention of Congress in framing the Transportation Act of 1920.

VII. Appellants in effect attack the whole 1920 scheme of legislation, first by urging a construction which would make it impracticable, and secondly by challenging its constitutionality. This Court has broadly upheld the constitutionality of the Act in all the cases which have involved its consideration. The application of the recapture clause invades no constitutional rights of Appellants.

VIII. Appellants' argument, when analyzed, is in effect a contention that the Commission erred because it did not fix the value of the carriers' railways solely on the basis of the cost of reproduction based on the prices prevailing at the recapture dates.

IX. The required payments by the O'Fallon are not confiscation. They leave to the Company in each of the years affected a net railway operating income in excess of six per centum of the value of the railway property held for and

used in the service of transportation, even on the basis of valuation contended for by the O'Fallon.

X. The provisions of Section 15a, paragraph (6), so far as the income of the Appellant Companies is concerned, took effect from and after the passage of the Act. Appellants' contention that the recapture provisions could not be applied to either of them until the results of the whole rate structure established by the Commission should realize the Congressional intention, is unsupported by the statute itself, or by reason.

XI. The District Court erred in holding that the Commission exceeded its power in directing the payment of interest on the sums which it found were payable by the O'Fallon.

ARGUMENT.

I.

The District Court correctly affirmed the conclusion reached by the Commission that the railways of the Appellant Companies did not constitute "a group of carriers under common control and management and operated as a single system" within the meaning of the Statute.

The correctness of the rulings of the Commission and the District Court, in this regard, is a fundamental question on this appeal, for if they were erroneous, the order of the Commission should be reversed and the matter remitted to it for further proceedings, because the Commission did not determine the value of the property of the Manufacturers.

But we submit that the Commission correctly inter-

preted the evidence, and fell into no error in the conclusion reached thereon, and that both the Commission and the Court correctly interpreted and applied the law.

Paragraph (6) of Section 15a, which makes recoverable and payable to the Commission for the purpose of establishing and maintaining the general railway contingent fund, described in the section, one-half of the net railway operating income in excess of six per centum of the value of the railway property received by any carrier for any year, further provides as follows:

> "For the purposes of this paragraph the value of the railway property and the net railway operating income of a group of carriers, which the Commission finds are under common control and management and are operated as a single system, shall be computed for the system as a whole irrespective of the separate ownership and accounting returns of the various parts of such system."

The United States, in its answer, maintained, and, in the District Court, contended, that under this provision, the finding of the Commission was a necessary prerequisite to computing the income received from a "system" as a whole, and that the failure of the Commission to so find was not reviewable by the Court (Rec., p. 114). The District Court in its final decree overruled this objection (Rec., pp. 148-149), and in both the majority opinion (Rec., pp. 132-136) and in that of Faris, D. J. (Rec., pp. 140-141), considered the question and held that the railways were not operated as a single system. This is assigned as error by the Appellants (Rec., pp. 155-156). The United States, however, has not appealed from so much of the decree of the District Court as overruled its contention that a review of the finding of the Commission was not

within the jurisdiction of the Court, and on this appeal the correctness of that ruling is not presented. The question whether or not the conclusion of the Commission that the two railways were not operated as a single system was correct is open for review. It is of primary importance.

It will be noted that the provision of Section 15a which creates the exception in favor of groups of carriers, requires three things to be found before single system treatment is to be accorded, (1) common control, (2) common management, and (3) that the carriers be "operated as a single system."

(a) *Passing over the question whether or not two can make "a group," in our view no conclusive evidence of common control is to be found in the record, and as a matter of fact the brief of appellants contains on its face an admission that there is no common control.* On page 120 of Appellants' brief it is stated:

> "There is almost complete common ownership and control of these two carriers, (R., 291) in the Estate of Adolphus Busch, and members of his family (Rec., p. 292)."

Mr. Wright, the Secretary of both Appellants, testified as follows:

> "There is almost complete common ownership of these properties. The Adolphus Busch Estate owns more than a majority of the stock of each. Excepting sixty-five shares of the Manufacturers' Railway Company's stock and a few qualifying director's shares, all of the stock of both Companies is owned *by the Adolphus Busch Estate or by members of the Busch family*" (Rec., pp. 291-292). (Italics ours.)

This, admitted to be true, is no evidence of common control. The list of stockholders of neither Company is in evidence. For all that appears, the Estate of Adolphus Busch through its executors or trustees, might own the major part of all the stock of the Manufacturers and the individual members of the Busch family who might, or might not own shares in the estate, the major part or all the stock of the O'Fallon. In other words, the "common" ownership of the stocks of the two Companies may depend entirely upon "common purpose" of a number of individuals, who, in the event of differences of opinion, might terminate the "common control" in a moment. The statute contemplates more than this: it implies "control," not "concurrence."

(b) *The question whether or not there was "single system operation" is almost entirely one of fact. Insofar as it is a question of fact, we submit this Court will not review it further than to ascertain that the findings of the Commission and of the District Court were supported by the evidence.*

This rule has been repeatedly stated and affirmed by this Court. The following are only a few of the cases so stating the rule:

Virginian Railway Co. v. *U. S.*, 272 U. S., 657, 665.

U. S. v. *Illinois Central R. Co.*, 263 U. S., 515.

Interstate Commerce Commission v. *Illinois Central R. Co.*, 215 U. S., 452, 470.

Chicago, Rock Island & Pacific R. Co. v. *U. S.*, 274 U. S., 29, 33.

Seaboard Air Line R. Co. v. *U. S.*, 254 U. S., 57, 62.

Interstate Commerce Commission v. *Union Pacific R. Co.*, 222 U. S., 541, 547.

Moreover, this Court refused to review a decision of the Interstate Commerce Commission on this very question of system operation in *The Los Angeles Switching Case*, 234 U. S., 294. The Court there was asked to review an order of the I. C. C. holding that certain spur tracks in Los Angeles were part of the carrier's system. The Court refused to review the question, saying (p. 311):

> "We must therefore take the findings of the Commission in the present case as to the character and manner of use of the industrial spurs in Los Angeles —that they constituted part of the carrier's terminals and that under the conditions there existing, the receipt and delivery of goods on these spurs was a like service as compared with the receipt and delivery of goods at team tracks and freight sheds—as conclusions of fact. Assuming that they were based upon evidence, they are not open to review."

And further, at page 314:

> "The argument for the petitioners necessarily invites the court to substitute its judgment for that of the Commission upon matters of fact within the Commission's province. That is not the function of the court."

It is only necessary, therefore, to show that there was evidence on which the Commission could have based its finding, and we submit that the finding was not only based on sufficient evidence, but that it was unquestionably in full accord with the weight of the evidence.

(c) *If the Court shall review the facts it will find the evidence conclusive in favor of the findings of the Commission.*

The facts shown by the evidence adduced before the Commission are accurately set forth in its Report (Rec., pp. 42-44), as follows:

"The Manufacturers' owns and operates about 30 miles of track in St. Louis, of which 5 miles are classified as main track and 25 miles as sidings or industrial tracks. Its construction was commenced in 1887 by the interests which controlled the Anheuser-Busch Brewing Association. The Manufacturers' is purely a switching road, moving cars between various industries and the trunk lines, or the line of the Terminal Railroad Association of St. Louis, hereinafter called the Terminal. It issues no waybills, but issues receipts to shippers and transmits bills of lading to the trunk lines by which regular waybills are made out.

"The O'Fallon operates about nine miles of main line and 12 miles of yard track and sidings in Illinois, the former extending from coal mines owned by the Adolphus Busch estate westward to a connection with the tracks of the Terminal in East St. Louis. Its traffic is almost exclusively coal in carloads, which is distributed widely through the Northwest, moving from origin on regular billing. Through the medium of the Terminal its shipments are delivered at various points in St. Louis, some of which are on the tracks of the Manufacturers'. Control of the O'Fallon was acquired by the Busch interests in 1913. The industries of the controlling interests have never used more than 8 per cent of the coal shipments from the O'Fallon. The distance between the railroad of the O'Fallon and the railroad of the Manufacturers' is about 12 miles, and communication by rail between the two properties is effected over the tracks of the Terminal, including a bridge over the Mississippi River. • • •

These carriers operate engines and other equipment from one line to the other over intervening tracks hereinbefore described; but there is no written contract or other arrangement for such use, and a special arrangement is necessary for each movement. Due to the difference in traffic handled by the Manufacturers' and the O'Fallon, there is no occasion for regular through operation of trains over the lines of these carriers.

"The Adolphus Busch estate owns a large majority of the stock of each carrier. The Manufacturers' has five directors and the O'Fallon seven. Three of these directors are common to both companies. All of the officers of these companies and all of the general office employees are common to both. The general offices are located in St. Louis. There is an engine repair shop located on the Manufacturers' in St. Louis and the O'Fallon has a car repair shop on its line. Repair work on equipment for both carriers is done at these shops as well as similar work for other carriers. Work done for either carrier in the shop of the other is charged for the same as for work done for any other carrier.

"The rates to and from points on the Manufacturers' are the St. Louis rates, to which the Manufacturers' is a party, and out of which it gets revenue in the form of a switching or terminal charge which is absorbed by the line-haul carrier. The O'Fallon is also a party to many joint rates with trunk lines. The companies render separate operating reports to us" (i. e., The Interstate Commerce Commission).

It was further shown that between these two carriers, there is an intervening rate established for transportation over the bridge, as to which neither of these companies

had any choice in the making, and the intervening carrier had no choice in the making of the rates of the two Appellant carriers; that there is an independent rate established between the two carriers applicable on all traffic and between all lines of the 29 carriers in the St. Louis Terminal District; that the O'Fallon is almost exclusively a coal road, and its whole equipment—almost exclusively—coal equipment (Rec., p. 296).

It was further shown that there is no steady movement of traffic from the Manufacturers' to the O'Fallon, or a movement that is productive of any dependable source of revenue. The O'Fallon is a "coal road" exclusively, and its east-bound traffic consists solely of mine supplies. Mr. Wright, the Secretary of both companies, testified:

> "The vast majority of industries on the Manufacturers' are manufacturing plants. Of course, their commodities are moving out. The O'Fallon is nothing more or less than a producer of raw material." (Rec., p. 374.)

Neither company itself issued waybills. The Manufacturers' is purely a switching and terminal Class 3 road. It does not issue waybills, but gives receipts, which are exchanged for waybills issued by the trunk lines. The O'Fallon issues regular separate bills, copies of which are sent to the trunk lines for the issuance of waybills (Rec., p. 294).

There had been no actual written operating agreement between the O'Fallon and the Manufacturers' at any time within the last ten years, and no lease; in each year there has been a separate and independent report to the Commission for the two companies, and in none of these reports is there any indication of operation as a single system (Rec., p. 306).

In short, the evidence showed two fundamentally different roads, twelve miles apart, with totally different types of traffic, with no regular through traffic, and but little exchange even in irregular traffic.

Appellants contend that because coal from the O'Fallon consigned to industries served by the Manufacturers' must move over the road of the latter, the two roads are necessarily complementary and form a single system. But it is clear that this situation, besides being true as to only a small percentage of the O'Fallon's traffic, is merely incidental. It is no more an argument why the O'Fallon and Manufacturers' should be treated as a system, than would be the similar situation if the New York Central had to use the Union Pacific to get freight from New York to Los Angeles. In the latter case, it would be absurd to contend that the two railroads formed a single system; and there is no distinction except in degree between that case and the one before this Court.

On behalf of the carriers, it was shown that the primary purpose of the acquisition of the O'Fallon by the Busch interests was a combining of the two properties and the establishment, in accordance with a promise made by Mr. Adolphus Busch, Senior, to the City of St. Louis, and the furtherance of his own personal plans, of establishing competition across the Mississippi River. About two years before the hearing before the Commission, plans for a consolidation and merger of these two properties were perfected and brought to Washington to present to the Commission. Upon receiving advice that the Commission could not approve such a merger until the consolidation of railways plan was finally adopted, the application was withheld, and was not filed with the Commission. The O'Fallon had acquired, and at the time of the hearing owned some thirty acres of land at the eastern end of the Municipal Bridge across the Mississippi River, which, the testimony

showed, was purchased and held for the purpose of making a direct connection between the roads as soon as the Municipal Bridge was opened for railroad use. Whatever the intentions may have been as to the future, the testimony conclusively showed that at the present time the railroads of the two companies are not "operated as a single system," even though they may be "under common control and management."

Appellants attempt to discount the physical separation of the carriers, by contending that, because of the decrees entered in the suit brought by the United States against the Terminal Railway Association of St. Louis (224 U. S., 383, modified in 236 U. S., 194), the relations between these two companies were such that

> "the rails and bridges of the Terminal that filled the physical gap between the rails of the carriers having their *termini* on the east side of the river, and those having their *termini* on the west side of the river, became *equivalent to extensions of the rails of such carriers over the intervening facilities of the Terminal*. This enables each line-haul carrier, including the O'Fallon, that transports freight into East St. Louis, to use the facilities of the Terminal in all respects and with the same effect, *as though they were extensions of its own rails*, for the purpose of reaching and interchanging traffic with trunk lines on the west side of the river, and for the purpose of making delivery of freight destined to industries in St. Louis that were served by either the Terminal or by the Manufacturers', or by those of the west side trunk lines (like the Wabash, Missouri Pacific, Frisco and Burlington) that have terminal and switching systems of their own in St. Louis" (Brief, p. 150).

The Appellants further contend that as a result of the decree in the *Terminal Cases*, the intervening gap in the transportation service is filled by or for Appellants. Consequently, Appellants do furnish *a complete chain,—a single unit of transportation service* (Brief, p. 151).

It is submitted that the decree in the Terminal Case had no such effect. The decision there was that the unification by the Association of substantially every Terminal facility by which the traffic of St. Louis is served, was a combination in restraint of interstate commerce within the meaning of the Anti-trust Law, as it showed an intent to destroy the independent existence of the terminal systems previously existing, to close the door to competition, and to prevent the joint use of the terminals by any non-proprietary company. The decree of the Court required the defendant to submit to the Court a plan for the reorganization of the contract between the 14 proprietary railroad companies and the Terminal Association, by providing for the admission of any existing or future railroad to joint ownership and control of the combined terminal properties, upon such just and reasonable terms as should place such applying company upon a plane of equality in respect of benefits and burdens with the existing proprietary companies, and that such plan of reorganization should provide definitely for the use of the terminal facilities by any other railroad, not electing to become a joint owner, upon such just and reasonable terms and regulations as would, in respect of use, character and cost of service, place every such company upon as nearly an equal plane as may be *with respect to expenses and charges* as that occupied by the proprietary companies. This amended decree was construed by the Court in *Terminal R. R. Assn. v. U. S.*, 266 U. S., 17.

It is not contended that either the O'Fallon or the

Manufacturers' applied for admission to joint ownership and control of the Terminal properties pursuant to the above mentioned decree; neither Company has a contract covering the privileges of its lines over the rails of the Terminal. Mr. Wright, Secretary of both corporations, testified:

> "We have an authorized right from the Terminal Railway Association. It is verbal and it is very simple. At any time in order to move trains either from one property to the other, we simply make agreements with the operating department, advise what time we wish the train to leave and ask them to furnish a pilot. It is not necessary to refer our requests to the executive officers. It is thoroughly understood as a matter of common practice at the St. Louis Terminal for several of the lines to do that. It is necessary with these movements. It is just an informal request upon their superintendent and various constituent properties" (Rec., p. 294).

Even were the contention of appellants sound on this point, it would still fall short of establishing that the two railways are operated "as a single system". At the very most, it shows no more than the possibility that the companies *might* use the Terminal tracks to bind themselves into a single system. But a mere possibility is irrelevant, when it appears so clearly that *in fact* these companies did not avail themselves of it. The evidence we have reviewed shows clearly that there was neither a regular movement of through traffic over the Terminal tracks, nor a substantial amount of irregular traffic. The record shows, and the brief of appellants admits (Rec., p. 299, Brief of Appellants, 127), that in 1922 and 1923 there was hardly any use of the Terminal Facilities. Any argument

based on physical connection through use of the Terminal facilities has, therefore, very slender basis in fact.

It is, in this respect, quite similar to the contention based on the fact that the O'Fallon had purchased land which it intends to use as a connecting link between the roads at some time in the future. Both point to what the companies might do in the future; they do not meet the requirements of the present. Since the question of "single system operation" arises only for the recapture periods, their consequent irrelevancy is obvious.

The fact that there is proof showing that in one month out of the four years in question 222 cars of coal were moved from the O'Fallon to consignees located on the Manufacturers' is made the basis of an inference by the Appellants, for which there is no other support, that the average monthly movements of coal from the mines of the O'Fallon to consignees on the Manufacturers' substantially exceeded 222 cars. By an easy gradation from that assumption, the further inference is made that there was "a constant flow of such traffic." Of course, there is no limit to the conclusions which can be built up on this sort of reasoning.

On the foregoing facts, the Commission held:

> "A system is something which is complete in itself, each part complementing the other parts to make up the whole. The two roads which we are asked here to consider as a system are separated by twelve miles of tracks of other railroads over which these carriers have no control. Considering the difference in the traffic handled and the lack of need of either road as a complement to the other, they could as well be a thousand miles apart. Common ownership or control is not the sole test. It is clear from the lan-

guage used that Congress intended that we should consider as systems only those groups of carriers which are operated under common control and management as interrelated and interdependent parts of a single whole. It is equally clear from the evidence of record that the O'Fallon and the Manufacturers' are not such a group of carriers" (Rec., p. 46).

Commissioner Taylor dissented from this conclusion largely because he thought the funds necessary to acquire ownership of these two railways flowed from the same source and complete control of both resided in the same interests (Rec., pp. 100-101).

In the District Court, Stone, J., stated in the majority opinion:

> "There is no substantial contradiction in the evidence, but the difference arises mainly from the conclusion of ultimate fact to be deduced from the evidence. There is little room for such difference, insofar as 'common control and management' is concerned, for the evidence is clear that the Adolphus Busch Estate owns a large majority of the stock of both carriers and that there is a common executive and office force which handles and controls the business of each" (Rec., p. 133).

As we have shown above, the evidence was that the majority stock was owned by the Busch Estate *"or by members of the Busch family"* (Rec., pp. 291-2).
The Court did not analyze the testimony as to stock ownership as we have done.

After reviewing the evidence summarized in the report of the Commission and the additional circumstances ap-

pearing in the record, the conclusion was reached that the Commission correctly had held these two carriers not to be "operated as a single system" within the meaning of this statute. The same conclusion was reached by Faris, D. J., in his concurring opinion, saying:

> "It may well be that here, the findings of the Interstate Commerce Commission upon this point are not reviewable by this Court. But the latter point need not be ruled. For, while it may, at least arguendo, be conceded that plaintiffs' railways are under 'common control and management,' the facts do not in my opinion, show that they are 'operated as a single system'" (Rec., 141).

We submit that both the Commission and the District Court were not only justified in finding that the facts showed that these two companies did not constitute a single system, but that their conclusion was unquestionably in accord with the weight of the evidence.

(d) *The interpretation by the Commission and the District Court of the expression "operated as a single system" was clearly correct.*

Appellant makes the further contention that the expression "operated as a single system" is not to be construed as requiring that the two companies actually be a single system, but that the key word of the phrase is "operation". The result is this: conceding that the companies are not a single system, the words "operated as a single system" should be paraphrased to read "operated as if they were a single system" or "operated as a single system would be operated."

It will hardly be necessary to point out to the Court that this construction is plainly contrary to the obvious

meaning of the English words; or that it ignores the directly expressed intention of Congress to provide that *systems of railways*, which are really single railroads, prevented by chance and circumstances from consolidation under a single corporate organization, be treated as they are in fact, not as they appear in legal relation. Appellants contention is that Congress did not have in mind the great systems like the Pennsylvania lines or the Rock Island lines, for whose benefit such a provision would be not only wise and equitable, but necessary; rather that it was considering the possibility of the unusual situation of a few small railroads.

Furthermore, if appellants contention were sound, it would render the expression tautologous, for it makes the use of the words "single system" meaningless. If Congress had intended to make a distinction between "management" and "operation", as contended, "single system" would never have been mentioned. The statute would have read "under common control, common management, and common operation." But Congress did use the words "single system", and must have intended that railroads, to come within the meaning of this exception, must constitute a single system.

Even if appellants' contention were sound, it is clear that they have not proved "common operation." Common *management* may have been shown, but appellants distinguish management from operation. Operation being confined to the mechanical aspects of the railroad, it is only necessary to point out that the engineers, brakemen, firemen, conductors, signalmen, and all other such employees, who actually operate the road, were separately employed, and assigned to work on one or the other of the railroads. If by any chance they were needed on the other road, their time was always carefully prorated between the two, and the expense borne in proportion to

the work done (Rec., p. 442). Further, the equipment was necessarily different. Is it contended that the coal cars which constituted the whole of the O'Fallon's rolling stock were used in common with the Manufacturers', which had no use for coal cars, or for anything but switching engines? A review of the evidence will show that the only things which the railroads had in common were things which must be ascribed to *management*, as appellants have distinguished that term from *operation*, and that there is practically no evidence of common operation, as the term is narrowly used. How could there be common operation of two railroads twelve miles apart, engaged in such totally different business?

II.

The District Court rightly refused to enter upon a trial *de novo* of the question of valuation.

On the trial in the District Court, the petitioners offered in evidence a certified copy of the record of the proceedings before the Interstate Commerce Commission in which the Commission issued its recapture order, including a transcript of all the evidence, oral and documentary, taken by the Commission before the making of its final report and order, and such incidental matters and documents as made up the complete record, not only as the record before the Commission itself, but also as constituting in its entire contents evidence *de novo* in the District Court, as bearing upon the issue of confiscation and damage (Rec., p. 178). This was objected to by defendants. The Court sustained the objections to its introduction as evidence *de novo*, and made the following ruling:

> "Section 12 of the Commerce Act as amended (24 Stat. 383; 25 Stat. 858; 26 Stat. 743; Compl. Stat. of

1916, Section 8576) makes it the duty of the Commission 'to execute and enforce the provisions of this Act.' Sections 13 (24 Stat. 383; 36 Stat. 550; Compl. Stat. of 1916, Section 8581) and 15 (24 Stat. 384; 34 Stat. 588; 36 Stat. 551; Compl. Stat. of 1916, Section 8583) as amended provided the outlines of a procedure which includes a hearing upon notice (fol. 6) with opportunity for all parties to be fully heard and there is ample provision for compulsory attendance of witnesses and documents and for procuring testimony in other sections of the Act as amended. Such full hearing was accorded plaintiffs in this matter by the Commission and no irregularity in the proceedings is claimed. No claim is made that controlling or important evidence has been discovered since the hearing nor that such character of evidence existed at the time of hearing but was not then but is now obtainable by the plaintiffs. Thus the situation is that a matter of fact has been properly committed by Congress to the Commission for ascertainment and determination by it; that adequate authority has, by Congress, been lodged in the Commission to enable it to accord a hearing thereon which is fair and complete as to all parties concerned; that such fair hearing has been accorded these plaintiffs and evidence has been introduced by them, and they have had full opportunity to present their views to the Commission; that afterwards, and based upon such hearing, the Commission had determined this matter of fact; that plaintiffs now desire to try this same matter of fact de novo before this court without respect to the evidence or proceeding before the Commission. We think this should not be done because such a course would effectually nullify the power of the Commission as a fact

finding body and substitute the courts in its place. We think the function of the courts as to such actions of the Commission is limited to reviewing the action of the Commission with a view of testing whether it has failed to act in accordance with the law governing its action and whether it has arbitrarily reached the conclusion at which it arrived. Obviously, a review of the action of the Commission must be upon the record before the Commission and none other because it was upon such record alone that the Commission should and is presumed to have acted. We think this view is required by numerous*ly* (*sic*) holdings of the Supreme Court of which the most recently reported is Western Chemical Co. v. United States, 271 U. S., 268, 271. Therefore, this court should not try this matter de novo but all evidence not before the Commission should be excluded." (Rec., pp. 180-181.)

Petitioners thereupon made a formal offer to prove the matters contained in the exhibit offered, not only as evidence of the record as it was before the Commission, but also as evidence *de novo* on the trial in the District Court. The Court said that its ruling, excluding the record tendered, applied only to the introduction and reception in evidence of the said exhibit as evidence upon the trial *de novo*, but that as evidence of what took place before the Commission, it was admissible, and it was admitted and marked in evidence (Rec., p. 182).

Petitioners Exhibits 4, 5, 6, 7, 8 and 9 were then offered and admitted in evidence as explanatory of and supplemental to certain portions of the record before the Commission (Rec., pp. 182-256).

Petitioners then offered in evidence certain other docu-

ments, which were objected to by the defendants, and the objections sustained upon the ground that the evidence tendered did not appear to have been referred to in the evidence introduced before the Commission, or in any way to have been before it when it determined the O'Fallon case (Rec., pp. 257, 258).

The petitioners thereupon made a formal offer of additional proof (Rec., pp. 277-286), which was objected to, and the objection sustained on like grounds.

No reason was stated by petitioner's counsel as to why all this evidence had not been submitted to the Commission. Certainly, ample opportunity had been afforded them to submit to the Commission all evidence which they considered pertinent and material. There is no pretense to the contrary. No case is presented, therefore, requiring the Court to substitute itself for the Commission as a fact finding body.

Appellants contend on this appeal that the Court erred in excluding this evidence and in not itself entering upon an inquiry into and determining the question of the value of the carrier's property (See their brief, p. 175). Specification of Errors, Nos. 34, 36 (their brief, p. 28).

Appellants argue:

> "The law is well established that if a constitutional issue is present in the case, the appellants are entitled to a trial *de novo* before the *Court*, with the right to introduce evidence. This was directly decided in the case of *Manufacturers' Railway Company* v. *Interstate Commerce Commission*, 246 U. S., 457, 489, 490, in which the Court held that, where the issue of the taking of property without due process was presented, the railroad was entitled to a trial *de novo* and to introduce evidence bearing on the issue, even though

such evidence had not been introduced in the case before the Commission" (Brief, p. 175).

This proposition was not so decided in the case cited. That case came before this Court on appeals from final decrees made by the District Court in two causes, dismissing petitions filed by the Appellants for the purpose of enjoining the enforcement of orders made by the Interstate Commerce Commission. On the trial in the District Court, the petitioners offered certain evidence bearing on the constitutional question which had not been before the Commission. The evidence was received over the objection of counsel for the Commission. The judgment of the Court was in favor of the United States and the Commission, and the petitions were dismissed. Appeals were taken from these judgments by the petitioners. Neither the United States nor the Commission appealed. Therefore, the question of whether or not the Court erred in receiving this evidence was not before this Court. It was, however, argued in this Court by the appellees that the finding of the Commission upon the subject of confiscation was conclusive, or at least that it was not subject to be attacked upon evidence not presented to the Commission, as was attempted in that case. This Court declined to sustain the objection in its entirety, and stated that it was not prepared to say that a party was debarred from attacking an order of the Commission upon constitutional grounds, even though they were not taken in the hearing before that body; that, nevertheless, correct practice requires that in ordinary cases, where the opportunity is open, all the pertinent evidence shall be submitted in the first instance to the Commission. It expressed its disapproval of the course that was pursued in these cases of withholding from the Commission essential portions of the

evidence that is alleged to show the rate in question to be confiscatory, and said (p. 490):

> "Certainly, where the Commission, after full hearing, has set aside a given rate on the ground that it is unreasonably high, it should require a clear case to justify a court, upon evidence newly adduced but not in a proper sense newly discovered, in annulling the action of the Commission upon the ground that the same rate is so unreasonably low as to deprive the carrier of its constitutional right of compensation."

However, the Court said that as the issue was in the case before it, it must be dealt with. Therefore it examined the evidence, and reached a conclusion favorable to the Commission, resulting in the affirmance of the decree appealed from. The utmost that can be said of this decision is, not that it directly established that "the Appellants are entitled to a trial *de novo* before a court, with the right to introduce evidence," but simply that the Court was not prepared to state that under no circumstances could a party claiming to be deprived of a constitutional right by the action of the Commission, be prevented from introducing evidence in support of its contention on trial in the court. Nothing in the evidence in the instant case shows that these Appellants had not the fullest opportunity to submit to the Commission all the pertinent evidence bearing upon their contentions, and no reason is adduced which should lead the Court to an exercise of the unusual reserve power to permit a consideration of the additional evidence offered, or to set aside the action which the District Court, in the exercise of its discretion, took in passing upon the objections to the evidence tendered.

In *Interstate Commerce Com.* v. *Union Pacific R. R. Co.*, 222 U. S., 541, 547, Mr. Justice Lamar, speaking for a unanimous Court said:

> "There has been no attempt to make an exhaustive statement of the principle involved, but in cases thus far decided, it has been settled that the orders of the Commission are final unless (1) beyond the power which it could constitutionally exercise; or (2) beyond its statutory power; or (3) based upon a mistake of law. But questions of fact may be involved in the determination of questions of law, so that an order, regular on its face, may be set aside if it appears that (4) the rate is so low as to be confiscatory and in violation of the constitutional prohibition against taking property without due process of law; or (5) if the Commission acted so arbitrarily and unjustly as to fix rates contrary to evidence, or without evidence to support it; or (6) if the authority therein involved has been exercised in such an unreasonable manner as to cause it to be within the elementary rule that the substance, and not the shadow, determines the validity of the exercise of the power. *Int. Com. Com.* v. *Ill. Cent.*, 215 U. S., 452, 470; *Southern Pacific* v. *Int. Com. Com.*, 219 U. S., 433; *Int. Com. Com.* v. *Northern Pacific*, 216 U. S., 538, 544; *Int. Com. Com.* v. *Alabama Midland Ry. Co.*, 168 U. S., 144, 174.
>
> In determining these mixed questions of law and fact, the court confines itself to the ultimate question as to whether the Commission acted within its power. It will not consider the expediency or wisdom of the order, or whether, on like testimony, it would have made a similar ruling. 'The findings of the Commission are made by law *prima facie* true, and this Court

> has ascribed to them the strength due to the judgments of a tribunal appointed by law and informed by experience.' *Ill. Cent.* v. *I. C. C.*, 206 U. S., 441. Its conclusion, of course, is subject to review, but when supported by evidence is accepted as final; not that its decision, involving as it does so many and such vast public interests, can be supported by a mere scintilla of proof—but the courts will not examine the facts further than to determine whether there was substantial evidence to sustain the order."

This statement of the law of judicial review has been adopted in all the succeeding cases. *Manufacturers Ry. Co.* v. *United States*, above cited is really not at variance with this general rule, except possibly to the extent above indicated.

In the *Assigned Car Cases*, 274 U. S., 564, 580, the Court said:

> "It is not for the courts to weigh the evidence before the Commission, or to enquire into the soundness of the reasoning by which its conclusions are reached • • •; or to question the wisdom of regulations it prescribes. • • • These are matters left by Congress to the administrative tribunal appointed by law and informed by experience, • • •"

Applying the rule settled by the foregoing cases, it is clear that no case was made in the District Court requiring or justifying that tribunal in entering upon a trial of the issues of fact committed to the Commission.

III.

The Commission in finding the value of the property of the O'Fallon held for and used by it in the service of transportation, proceeded in precise conformity with the statute. It gave "due consideration to all the elements of value recognized by the law of the land for rate-making purposes," and, gave "to the property investment account of the carriers only that consideration which under such law it is entitled to in establishing values for rate-making purposes."

The report of the Commission describes just how it proceeded to determine this value.

Section 15a, paragraph (6) provides:

> "The value of such railway property shall be determined by the Commission in the manner provided in paragraph (4)."

Paragraph (4) enacts:

> "The Commission may utilize the results of its investigation under section 19a of this Act in so far as deemed by it available, and shall give due consideration to all the elements of value recognized by the law of the land for rate-making purposes, and shall give to the property investment account of the carriers only that consideration which under such law it is entitled to in establishing values for rate making purposes."

The report states that when this proceeding was instituted, the Commission had not made a valuation of the property of the O'Fallon or the Manufacturers for any of the recapture periods or for any other period (Rec., p.

12). The investigation for that purpose was in progress, but had not been concluded. Certain results of that investigation, however, were available, and exhibits setting these forth were made a part of the record in the proceeding. The report says:

> "The usual accounting, engineering and land reports prepared by our bureau of valuation, hereinafter referred to as the bureau, in accordance with instructions, rules, regulations, and methods approved by us, had been served upon the carrier prior to the commencement of this proceeding. Testimony and exhibits presented by the carrier and the bureau in this record, in so far as these relate to the value of this carrier's property, make reference to, and to a considerable extent are based upon, these underlying reports. The reports themselves were introduced in evidence in exhibit form."

Section 19a directs the Commission in making the investigation required to enable it to ascertain and report the value of all the property owned or used by every common carrier subject to the provisions of the Act, to

> "ascertain, and report in detail as to each piece of property, other than land, owned or used by said common carrier for its purposes as a common carrier, the original cost to date, the cost of reproduction new, the cost of reproduction less depreciation, and an analysis of the methods by which these several costs are obtained, and the reason for their differences, if any. The Commission shall in like manner ascertain and report separately other values, and elements of value, if any, of the property of such common car-

rier, and an analysis of the methods of valuation employed, and of the reasons for any differences between any such value and each of the foregoing cost values" (Subsection [b], paragraph First).

It also provides that

"such investigation and report shall state in detail and separately from improvements the original cost of all lands, rights of way, and terminals owned or used for the purpose of a common carrier, and ascertained as of the time of dedication to public use and the present value of the same" (Subsection [b], paragraph Second).

It also provides that in ascertaining the original cost to date of the property of such carrier,

"the Commission in addition to such other elements as it may deem necessary, shall investigate and report upon the history and organization of the present and of any previous corporation operating such property; upon any increases or decreases of stocks, bonds, or other securities, in any reorganization; upon moneys received by any such corporation by reason of any issues of stocks, bonds, or other securities; * * * and upon the net and gross earnings of such corporations; and shall also ascertain and report in such detail as may be determined by the Commission upon the expenditure of all moneys and the purposes for which the same were expended" (Subsection [b], paragraph Fourth).

The Commission's report stated:

"The language of Section 15a indicates the desire of Congress that the measures inaugurated be put

in force as promptly as possible, and while we are required by paragraph (4) to 'give consideration to all the elements of value recognized by the law of the land for rate-making purposes,' it is also provided that 'for the purposes of this section, such aggregate value of the property of the carriers shall be determined by the Commission from time to time and as often as may be necessary.' There is an entire lack of direction as to specific methods of procedure, and Congress apparently entertained the view that valuations under Section 15a 'might be made in a more summary manner than valuations under Section 19a" (Rec., p. 42).

Referring to the direction of the statute that in determining values pursuant to Section 15a the Commission shall "give due consideration to all the elements of value recognized by the law of the land for rate making purposes," the Commission reports:

> "In the methods of valuation which we have followed in this proceeding we have endeavored to give heed to this direction, having in mind not only the conditions existent upon these particular carriers, but also the necessity in the application of these methods to the carriers generally of protecting the private owners of railroad property in their constitutional rights and at the same time of assuring to the public the continued maintenance and operation of a transportation system capable of rendering efficient service at reasonable rates" (Rec., p. 53).

The Commission referred to the "fair value" rule as initiated in *Smyth* v. *Ames*, 169 U. S., 466, which it said, "lies at the root of this and other valuation proceedings." It noted, however, that while that case held that the

> "'basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public' * * *. It laid down no definite rule for determining 'fair value' but enumerated certain 'matters for consideration' to be given 'such weight as may be just and right in each case'" (Rec., p. 62).

And that,

> "Later in the *Minnesota Rate Cases*, 230 U. S., 352, 434, the Court made it clear that the determination of such value is 'not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts'" (Rec., p. 62).

One of these factors, it was noted, was "the present as compared with the original cost of construction," and it was this factor, rechristened "cost of reproduction new at prices current on valuation date," that the Commission was urged "to take as the basic measure of fair value, to the exclusion of all other factors, except to the extent that it may be augmented by an allowance for something called 'going value', which is vaguely defined in many different ways" (Rec., p. 62).

The Commission declined to yield to the adoption of the cost of reproduction new at current prices method to the exclusion of everything else. It pointed out that the use of cost of reproduction was by no means free from practical difficulties. For example, the record here showed that there was a dearth of reliable data from which an accurate estimate of such cost could be made for the period

1920 to 1923. There was in fact very little new railroad construction in those years (Rec., p. 63). The report points out the consequences of using the cost of reproduction in each of the recapture periods of all railroad property in the United States, showing that while the aggregate value of property used for transportation purposes, at the time of the general rate increase of 1920 was $18,950,000,000, the value of precisely the same structures on the cost of reproduction basis, figured on the current commodity prices, would have been 41.4 billions in 1920, 35.1 billions in 1921, 28.3 billions in 1922, and 31.3 billions in 1923; that

> "these huge 'profits' and 'losses' would have occurred without change in the railroad property used in the public service other than the theoretical and speculative change derived from a shifting of general price levels. To put it still more graphically, by the application of the current reproduction cost doctrine the assumed base of 18 billions would have been increased in 1920 by a sum greater than the present national debt (about 19 billions), and the transportation burden upon the people of the country would have been correspondingly increased without the investment of a single dollar by those who would reap the benefits" (Rec., p. 66).

The report then discussed a system of valuation for rate making purposes, based on actual legitimate investment, which it says would have many appealing features, but notes that there are practical difficulties in the way of the adoption of such a system, among others, that there is an almost complete lack, prior to 1907, of the definite and dependable records which would be essential. In reality, the Commission says,

"the valuation problem is divided into two parts, which can be quite clearly distinguished, and the date when our valuation work under Section 19a began marks roughly the division line between these two parts. Since that date we have required the carriers to report in detail all property changes and their costs, and these costs can be verified and checked. In the case of all property which came into existence prior to that date we have an inventory made by our own engineers, but no complete, reliable information as to original costs. The first part of our problem, therefore, is to determine upon a fair single-sum value for this older property. The second part of our problem is to bring this value down to any subsequent date, in the light of the property changes since our valuation work began, of which we have complete reports" (Rec., p. 71).

The methods which the Commission followed in determining the basic values of the older property, they say, have been described at length in their valuation reports under Section 19a:

"Briefly, we have had before us the cost of reproduction new of the structural portion of this property estimated on the basis of our 1914 unit prices, coupled with the knowledge that costs of reproduction so arrived at were not greatly different from the actual original costs. We have had complete information as to depreciation of this property, in other words, as to that portion which in reality had ceased to exist because of the consumption of service life. We have had complete information as to the value of the railroad lands, based on the contemporaneous market values of adjoining and adjacent lands. We

have had information, as complete as could be secured, relative to the financial and corporate history of the property, including its past earnings. We have further had such information as could be developed with reference to possible appreciation in the value of certain parts of the property because of better adaptability for use, and with reference to such other matters as the carriers desired to bring to our attention.

"*From this accumulated information we have formed our judgment as to the fair basic single-sum values, not by the use of any formula but after consideration of all relevant facts.*" (Italics ours.) (Rec., p. 71.)

The report recites:

"In more than four hundred reports relating to the value of individual railroad properties we have said:

" 'The estimates of cost of reproduction covered by this report are based upon what is referred to herein as the 1914 level of prices, while the present values of of the common-carrier lands covered by the report are based upon the fair average of the normal market value of lands adjoining and adjacent to the rights of way, yards and terminals of the carrier, as of valuation date. This discrepancy will be removed when the commission adjusts to later dates, in accordance with the requirements of the Valuation Act, the final value herein reported.'

"What we are doing in the instant case is in conformity with our understanding of this language" (Rec., p. 72).

The Commission further reported that:

"The underlying engineering report on which the tentative valuation in the 19a proceeding is in part to be based, contains estimates of cost of reproduction new and cost of reproduction less depreciation as of June 30, 1919, based upon 1914 unit prices. These unit prices have been determined, as explained by us in numerous reports in valuation cases, by consideration of the prices for labor and materials and the cost of constructing and equipping railroads, in most instances during a five-year period ending June 30, 1914, but in certain other instances during periods of ten years or more ending June 30, 1914. *Texas Midland Railroad*, 75 I. C. C., 1.

"There are also in evidence estimates by our bureau of the cost of reproduction new and reproduction less depreciation of the property which the carrier owned and used in performing transportation service on December 31, 1920, 1921, 1922, and 1923. The prices used by our engineers in formulating these estimates were the 1914 unit prices as previously defined. The quantities in the several accounts comprised in the reproduction cost schedules were determined by taking the inventory made as of June 30, 1919, and allowing for additions of new units placed in service and subtractions of units retired from service since that date. Reports made by the carrier to us, which have been verified, show such additions or retirements subsequent to June 30, 1919" (Rec., pp. 55-56).

As a result, the following table was presented as showing the cost of reproduction new and reproduction less depreciation of the property of the O'Fallon, exclusive of

land, on the dates mentioned, based on the 1914 unit prices (Rec., p. 56):

Date	Cost of Reproduction New	Cost of Reproduction Less Depreciation
June 30, 1919	$927,884.	$678,506.
Dec. 31, 1920	936,732.	658,531.
Dec. 31, 1921	950,553.	692,923.
Dec. 31, 1922	951,974.	674,769.
Dec. 31, 1923	940,708.	645,466.

The report further shows the valuation of land and the determination of the amount of working capital necessary, all of which were used in the final determination of the "fair value" of the railroad property (Rec., pp. 73-74).

The conclusion of the report was:

> "Weighing the figures previously mentioned in the light of these considerations and the entire record, and viewing the carrier as a common carrier in successful operation and with an established business, we conclude that the value for rate making purposes of the entire common carrier property of the O'Fallon on June 30, 1919, was $850,500" (Rec., p. 74).

The foregoing extracts from the report of the Commission indicate what a fuller perusal of that document will convince, that the Commission did not, as contended by the appellants, base its findings of value

> "on a mathematical formula, the avowed purpose of which was to determine the approximate investment in the property as distinguished from its present value" (Brief, p. 52).

IV.

The true basis for the determination of public utility valuation was laid down in the case of Smyth v. Ames, 169 U. S., 466, which is still the law. The decision in that case sets up, not a formula, but a standard of evidence, holding that neither reproduction cost nor original cost is alone a criterion of value, or to be given dominant consideration, but that the rate-making body must take all elements and measures of value into consideration, and analyze and ascribe to each its proper weight, in the light of the evidence of the case.

The items which are to be considered in arriving at the valuation of a public utility for rate-making purposes were set forth in the case of *Smyth* v. *Ames, supra,* as follows:

> "We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case" (pp. 546-7).

This doctrine has been quoted in most of the cases involving the question of valuation which have arisen since

Smyth v. *Ames*, and has been approved in practically every one of them, including the most recent, *McCardle* v. *Indianapolis Water Co.*, 272 U. S., 400. It is still unquestionably the law.

All the confusion which has been injected into the question is due to the persistent efforts of counsel in this class of cases: counsel for the utilities attempting in each case to secure the highest possible valuation; counsel for the rate-making bodies usually trying to secure the lowest—both concerned only with the expediency of the moment.

Prices, however, have not remained stable. They have fallen to very low levels, and then risen again to new heights. Counsel have had continually to adapt themselves to new situations. For instance, in *Smyth* v. *Ames* it was the utility which argued for original cost, and the state which contended for reproduction cost; while in the *Bluefield case*, 262 U. S., 679, the utility contended for the reproduction cost and the state for original cost.

The result has been that the problem has been dominated by this consideration of reproduction cost, since its variability was the real cause of all the difficulty, and since the business practices of the earlier utilities often made it the only honest test. It came to pass, indeed, that reproduction cost was, in many cases, the only basis found worthy, after due deliberation, to be used as the basis of the valuation in question. It is not surprising, then, that courts have made statements in many of the cases which seem on the surface to lend color to the contentions of those who advocate the adoption of the spot reproduction theory.

But it should be remembered that reproduction cost gained its ascendancy in a period when public utilities were unregulated, more from the disrepute of the other elements of value than from its own merit; and that

its use in each case was dependent upon a mature and deliberate consideration by the rate-making body of all elements of value, with the conclusion that the true value was nearer the reproduction cost than any of the other elements of value.

With this in mind, and with the rule of *Smyth* v. *Ames* before us, it is clear that all the cases in this Court approving valuations based on reproduction cost, found under the rule of *Smyth* v. *Ames*, are not authorities for the proposition that the rule of reproduction cost is either permanent or exclusive. Actually they sustain the contrary proposition: that when the circumstances make reproduction cost an unfair measure of value (as we shall demonstrate is the case here), and when the facts of the case do not justify giving it the same weight as other possible elements of value, it is proper to relegate it to a subordinate place.

The question of the basis of valuation for rate-making purposes was never squarely raised before the case of *Smyth* v. *Ames*, for in the cases which first applied the principles of *Munn* v. *Illinois* to Railroads; *C. B. & Q. R. R.* v. *Iowa*, 94 U. S., 155, and *Peik* v. *C. & N. W. R. R. Co.*, 94 U. S., 164, the Court was inclined to leave the whole question of rates to the legislatures, without any judicial review whatever. The Court said in the *Peik case*, page 178:

> "Where property has been clothed with a public interest, the Legislature may fix a limit to that which shall in law be reasonable for its use. This limit binds the courts as well as the people. If it has been improperly fixed, the legislature, not the courts, must be appealed to for the change."

The court, however, soon receded from this extreme position, in *The Railroad Commission Cases*, 116 U. S., 307, and in *Dow* v. *Beidelman*, 125 U. S., 680; and established

finally in *C. M. & St. P. R. Co.* v. *Minnesota,* 134 U. S., 418, that legislatures could not establish rates which were confiscatory and at the same time prohibit a review by the courts. In none of these cases, however, was the basis for testing the reasonableness of the rates decided upon. That was left for the next decision of the Court, *Smyth* v. *Ames,* 169 U. S., 466.

In that case, the plaintiffs, stockholders in the Companies whose lines in Nebraska were affected by these rates, sued to enjoin the Companies from putting them into effect, and the Nebraska Board of Transportation from enforcing them, upon the ground that they deprived the Companies and their shareholders of rights guaranteed to them by the 14th Amendment. Mr. Justice Brewer, sitting at Circuit, heard the case, and granted a permanent injunction, upon the ground that the Nebraska Act was repugnant to the Federal Constitution, because by its provisions the Companies might not exact for the transportation of freight from one point to another within the State, charges which would yield to them, respectively, reasonable compensation for such services.

On appeal to the Supreme Court, this decree was affirmed without dissent, Mr. Justice Harlan writing the opinion.

The constitutionality of the Nebraska statute, which fixed the maximum rates chargeable, was the question argued and decided by the Court.

Practically all the lines in Nebraska at that time had been built through the wilderness at very high cost, which included not only the actual legitimate cost, but much watering of the stock, bribery and injudicious and corrupt contracts. The books had never been properly or honestly kept and there was little good evidence of the original actual investment. Under these circumstances Nebraska

refused to bear the burden of rates based on such capitalization, and fixed the rates in question, basing them on the reproduction value, new. The railroads contended that either original cost or capitalization should be the base. The cost of reproduction was only about a third of the original cost. The rates were clearly unfair if the railroads' valuation was correct; clearly fair if the states's contention prevailed. The Court then considered the proper basis of value, finding that the radical nature of the opposing claims made any precise standard out of the question, since neither contention was reasonable. Reproduction cost was clearly unfair to the companies which had put their line through a wilderness during a period of high prices; and original cost, based on payments in watered stock, bonds under par, on contracts obtained through bribery, and given as a result of corruption, was equally unfair to the public. It desired to approximate the amount which the railroad *ought to have cost*, and with this in mind enunciated the famous doctrine quoted above, which may be summarized as providing that all possible criteria of value are to be carefully weighed, and the result which is most just and reasonable *in the light of the particular case*, is to be taken as *the fair value* of the property. The quoted language of the Court amply illustrates the reasoning of the Court:

> "But the rights of the public would be ignored if rates for the transportation of persons or property on a railroad are exacted without reference to the fair value of the property used for the public or the fair value of the services rendered, but in order simply that the corporation may meet operating expenses, pay the interest on its obligations, and declare a dividend to stockholders.
>
> "If a railroad corporation has bonded its property

for an amount that exceeds its fair value, or if its capitalization is largely fictitious, it may not impose upon the public the burden of such increased rates as may be required for the purpose of realizing profits upon such excessive valuation or fictitious capitalization; and the apparent value of the property and franchises used by the corporation, as represented by its stocks, bonds and obligations, is not alone to be considered when determining the rates that may be reasonably charged (pp. 544-5).

* * * * * * * *

"A corporation maintaining a public highway, although it owns the property it employs for accomplishing public objects, must be held to have accepted its rights, privileges and franchises subject to the condition that the government creating it, or the government within whose limits it conducts its business, may by legislation protect the people against unreasonable charges for the services rendered by it. It cannot be assumed that any railroad corporation, accepting franchises, rights and privileges at the hands of the public, ever supposed that it acquired, or that it was intended to grant to it, the power to construct and maintain a public highway simply for its benefit, without regard to the rights of the public. But it is equally true that the corporation performing such public service and the people financially interested in its business and affairs have rights that may not be invaded by legislative enactment in disregard of the fundamental guarantees for the protection of property. The corporation may not be required to use its property for the benefit of the public without receiving just compensation for the services rendered by it. How such compensation may be ascertained, and

what are the necessary elements in such an inquiry, will always be an embarrassing question (pp. 545-6).

* * * * * * * *

"We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case" (pp. 546-7).

Applying this test to the facts of the case, the Court found that upon any reasonable valuation the rates would be confiscatory. The point actually decided by the Court was that reproduction cost new was not in that case a proper basis for valuation.

The case sets up, therefore, not a formula, but a standard. It holds clearly that neither the reproduction cost nor the original cost is alone correct, as a matter of law, or is to be given "dominant consideration," but that the rate-making body must take all elements and measures of value into consideration, analyse each *in the light of the facts of the case*, and ascribe to each its proper weight. When this has been done, the rule of *Smyth v. Ames* has been followed.

During the decade that followed *Smyth v. Ames*, how-

ever, circumstances conspired to enhance the reputation of the reproduction cost basis at the expense of all the other measures of value. This was before regulation of utilities by commissions had become common, and the carefree methods of the promoters of utilities in financing and construction, had rendered estimates of original cost difficult and unreliable, and capitalizations in most cases frankly unrepresentative of any sort of value. Reproduction cost, not being subject to the effects of the business ethics of the time, profited by the suspicion and disrepute into which capitalization and original cost had fallen, and became the commonly accepted measure of value. This was generally satisfactory to both commissioners and utilities because the price level maintained itself fairly stable during most of the period.

That this is the real reason for the frequent use of the reproduction cost basis before the war is very well illustrated by the case of *Knoxville* v. *Knoxville Water Co.*, 212 U. S., 1, which often is cited in support of the reproduction cost rule. It there appeared that the plant had been constructed under contracts which provided for payment in stocks and bonds without any declaration either of the dollar value of the construction or the price of the securities. For instance, one contractor had received, for work which the court found could not have been worth more than $125,000, $200,000 of stock and $125,000 of bonds. This contract is representative of the whole situation. The court applied the rule of *Smyth* v. *Ames*, but, *in the light of all the facts* as required by *Smyth* v. *Ames*, what could the court do but hold that the only real basis of estimation was reproduction cost? Especially as price levels were stable and reproduction cost was actually close to what the property should have cost.

Yet counsel for utilities in later years, when reproduc-

tion cost had doubled, continually and triumphantly pointed to the *Knoxville case* as authority for the proposition that reproduction cost was *in all cases, as a matter of law*, the only constitutional basis of valuation. It established no such principle, nor was the *Knoxville case* the only one in which the same rule was applied. An examination of any of the pre-war cases will show that the Supreme Court was doing no more than holding that a rate-making body could, in the light of all the facts of the particular case, find a value based primarily on reproduction cost, rather than on any of the other elements of *Smyth* v. *Ames*. Compare:

Willcox v. *Consolidated Gas Co.*, 212 U. S., 19;
Minnesota Rate Cases, 230 U. S., 352;
Des Moines Gas Co. v. *Des Moines*, 238 U. S., 153;
Cedar Rapids Gas & Light Co. v. *Cedar Rapids*, 223 U. S., 655;
Omaha v. *Omaha Water Co.*, 218 U. S., 180;
San Diego Land Co. v. *National City*, 174 U. S., 739;
San Diego Land Co. v. *Jasper*, 189 U. S., 439;
Newton v. *Consolidated Gas Co.*, 258 U. S., 165;
Galveston Elec. Co. v. *Galveston*, 258 U. S., 388;
Denver v. *Denver Union Water Co.*, 246 U. S., 178.

There are other cases, but these cases include all pre war cases relied on by Appellants, and all are essentially the same. To contend that any of them holds that, as a matter of law, a valuation not based on reproduction cost new (less depreciation, of course) is confiscatory, is utterly unjustifiable.

Actually, every one of them is an authority for the contention of the United States and of the Interstate Commerce Commission in this case. Every one of them is based on the rule of *Smyth* v. *Ames*, and if they are authority for the proposition that rate-making bodies could and should give dominant consideration to reproduction cost at a time when other elements of value were admittedly unreliable and undesirable as bases, and when reproduction cost was not only the only reliable base, but *actually did* approximate the value of the investment, they are equally good authority for the proposition that at a time when abnormal prices have swollen reproduction cost out of proportion, the rate-making bodies may, *in the light of all the facts*, accord it *less*, rather than *more* weight. Especially is this so since the other elements of value are now, due to strict regulation, fairly certain and wholly reliable—in fact, infinitely more so than the now fluctuating reproduction cost.

The opinions of the Court in these cases bear out this interpretation of the decisions, though it is possible to find isolated sentences which, on first impression, may seem inconsistent. An oft quoted paragraph from the opinion in *Willcox* v. *Consolidated Gas Co.*, *supra* is this (p. 52):

> "If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase."

That this sentence was not intended as an expression of constitutional requirement, but was merely a statement of the general practice of rate-making bodies at that time, is abundantly clear from the remainder of the paragraph, viz:

"This is, at any rate, the general rule. We do not say there may not possibly be an exception to it, *where the property may have increased so enormously in value as to render a rate permitting a reasonable return on such increased value unjust to the public.* How such facts should be treated is not a question now before us, as this case does not present it. We refer to the matter only for the purpose of stating that the decision herein does not prevent an inquiry into the question when, if ever, it should be necessarily presented" (p. 52). (Italics ours.)

Counsel for Appellants cites *San Diego Land & Town Co. v. Jasper, supra,* in support of the proposition that this Court has rejected investment cost as a rate-making basis (Brief, p. 78). But that case involved no more than the question whether this Court would overturn a valuation which was obviously based entirely on reproduction cost to the exclusion of all other elements. The Court there said (by Mr. Justice Holmes):

"It is no longer open to dispute that under the Constitution 'what the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public.' * * * That is decided, and is decided as against the contention that you are to take the actual cost of the plant, annual depreciation, etc., and to allow a fair profit on that footing over and above expenses. * * *

"Yet the only evidence in favor of a higher value in the present case, is the original cost of the work, seemingly inflated by improper charges to that account and by injudicious expenditures, (being the cost to another company which sold out on foreclosure to

> the appellant,) coupled with a recurrence to testimony as to the rapid depreciation of the pipes. * * * No doubt cost may be considered, and will have more or less importance according to circumstances. In the present case, it is evident for reasons some of which will appear in a moment that it has very little importance indeed" (pp. 442-443).

It is obvious that Mr. Justice Holmes was merely applying the rule of *Smyth* v. *Ames* to the particular facts of the case.

Similarly in the *Minnesota Rate Cases*, at page 434, the Court quoted with approval what was said in *San Diego Land & Town Co.* v. *National City*, 174 U. S., 739, 757:

> "What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public."

The Court then continued as follows:

> "The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts. The scope of the inquiry was thus broadly described in *Smyth* v. *Ames* * * *: 'In order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters

> for consideration, and are to be given such weight as may be just and right in each case," (pp. 434-5).

Later in the opinion the Court said:

> "The cost-of-reproduction method is of service in ascertaining the present value of the plant, when it is reasonably applied and when the cost of reproducing the property may be ascertained with a proper degree of certainty" (p. 452).

So much for the earlier cases. We turn now to the cases which arose after the war, when the enormous rise in prices had transformed the reproduction cost basis as far as the utilities were concerned, from a sometimes convenient, but usually annoying, measure of value, to a veritable El Dorado—containing, it is true, more than a proper share of the delusiveness of the original, but at the same time holding forth hopes quite as rich. The inevitable result was a drive by the utilities to get rid of the restrictions which the broad rule of *Smyth* v. *Ames* wisely permitted commissions and courts to place on their claims, and to substitute therefor the reproduction cost theory as a minimum requirement in valuation. This O'Fallon case is one step in that drive. There have been four previous cases in which this valuation question was raised—at least, raised well enough to have merited attention from the Court. They are the *Southwestern Bell Telephone Case*, the *Georgia Railway & Power Co. Case*, and the *Bluefields Water Co. Case*, all in 262 U. S., and the *McCardle Case*, in 272 U. S. There have been other cases in which valuation has appeared incidentally, but these four are the only ones of importance.

The first of these cases is *Southwestern Bell Telephone Co.* v. *Public Service Commission of Missouri*, 262 U. S.,

276, which is especially interesting as containing an opinion by Mr. Justice Brandeis, concurred in by Mr. Justice Holmes, in which he *concurs in the result*, but dissents from the reasoning of the majority. His opinion is a defense of the so-called "prudent investment" theory of rate valuation, as opposed to the reproduction cost theory. In arguing from this opinion we do not wish to be taken as embracing the prudent-investment theory, but we do wish to point out that the *concurrence* of Justice Brandeis and Holmes *in the result*, while they attack the reproduction cost theory, is enough without more to demonstrate that that case cannot be in any way derogatory of *Smyth* v. *Ames*. The basis of their concurrence in the result is found in the fact that no evidence was introduced by the Commission regarding reproduction cost, and that no consideration whatever was given to it, which might well be contrary to the rule of *Smyth* v. *Ames*. That this, and not adherence to the reproduction cost theory, is the true basis of the decision, is clear, when we further consider Mr. Justice McReynold's estimate of $25,000,000 as a proper value, although the *undisputed* evidence of the company's engineers had placed the reproduction cost at $35,000,000. It is clear from the opinion of the majority, as well as from the concurrence of Justices Brandeis and Holmes, that *Smyth* v. *Ames* was the basis of the decision.

We turn next to the case of *Bluefield Water Works* v. *Public Service Commission of West Virginia*, 262 U. S., 679. This case also contains a concurrence by Mr. Justice Brandeis in the judgment, while dissenting from the opinion on the same grounds as in the *Southwestern Telephone case, supra*. The opinion of the majority proceeded directly on the authority of *Smyth* v. *Ames*, quoted the rule as stated in that case, found that the commission had given no consideration whatever to anything but actual

cost less depreciation, and held, *in the light of all the facts*, that the failure to consider reproduction cost was unreasonable. Surely there is nothing in such a decision contrary to *Smyth* v. *Ames*. Rather it is a complete vindication of the correctness of that case.

The third case is *Georgia Railway & Power Co.* v. *Railroad Commission of Georgia*, 262 U. S., 625, decided the same day as the *Bluefield case*, *supra*, and if anything more were needed to show that the Court in both the *Bluefield* and *Southwestern cases* was adhering to the rule of *Smyth* v. *Ames*, this decision furnishes it. The question involved was the propriety of a valuation of a gas company, where the commission fixing the rate had applied the 1914 reproduction cost to such property as was in existence at the time, against the objection that the 1921 reproduction cost should have been the basis of the valuation. It appeared that the Court had given mature consideration to the present reproduction costs, but had concluded that "present fair value" did not necessarily mean "present replacement cost," particularly in view of the abnormal conditions prevailing in 1921. This the Court approved, in an opinion by Mr. Justice Brandeis, in which it was said that

> "there was no rule which required that in valuing the physical property there must be 'slavish adherence to cost of reproduction, less depreciation'" (p. 630).

There could not well be a clearer adherence to the rule of *Smyth* v. *Ames*, nor a case more nearly like that at bar. Surely, even if the opinions in the *Southwestern Telephone case* and the *Bluefield case* did contain anything ambiguous on this point (though we have shown that they are clearly based on *Smyth* v. *Ames*), this case, decided the same day, removes any question. That the Court con-

sidered possible inconsistencies between this case and the other two appears from the dissenting opinion of Mr. Justice McKenna, and it is significant that eight of the nine judges saw nothing inconsistent.

The last case is *McCardle* v. *Indianapolis Water Co.*, 272 U. S., 400, which appellants cite at six places in their brief and upon which evidently they place great reliance. We think that this reliance is seriously misplaced, for there is nothing in the case to show that the Court required as a minimum valuation, present reproduction cost less depreciation. On the contrary, it clearly appears that it did not. The valuations on the present reproduction cost less depreciation basis, ranged from a minimum of $19,500,000 upwards, without the addition of any of the other items, such as cash working capital. The real reproduction cost was shown to be in excess of $22,000,000; yet the Court approved a valuation of $19,000,000. That the Court recognized this discrepancy is clear from the language of the opinion:

> "While some expressions of the District Judge indicate that he was of opinion that dominant or controlling weight should be given to cost of reproduction less depreciation estimated on spot prices as of January 1, 1924, it is clear that the $19,000,000 fixed by him as the minimum value could not have been arrived at on that basis" (p. 418).

The real basis of the decision is found in these words of the Court:

> "The decision of this Court in *Smyth* v. *Ames*, 169 U. S., 466, 547, declares that to ascertain value 'the present as compared with the original cost of construction' are, among other things, matters for con-

sideration. But this does not mean that original cost or the present cost or some figure arbitrarily chosen between these two is to be taken as the measure. The weight to be given to such cost figures and other items or classes of evidence is to be determined *in the light of the facts of the case in hand*" (p. 410). (Italics ours.)

The facts of this case were admittedly peculiar. The company had built up an adequate and paying plant from the meagerest materials, with tremendous effort, and with great beneficial effect to the city. It was clear that the city authorities had turned on a public-spirited company with oppressive and unfair methods. Their valuation was obviously too low. In the light of these facts, approval by this Court of a valuation which clearly represented a compromise figure, cannot with any show of reason be held to be a commitment to the reproduction cost less depreciation theory. The single fact that Mr. Justice Holmes was able to concur in the result is sufficient corroboration of our analysis, even if the language of the court were not clear on the point.

In fact, we shall take the text which we believe to represent the state of the law regarding the proper method of evolving valuations in rate cases from the opinion of Mr. Justice Butler in this *McCardle case*, apparently regarded by Appellants as their strongest authority. We repeat the language we have quoted above:

> "*The decision of this Court in Smyth* v. *Ames*, 169 U. S., 466, 547, *declares that to ascertain value 'the present as compared with the original cost of construction' are, among other things, matters for consideration. But this does not mean that the original cost or the present cost or some figure arbitrarily*

chosen between these two is to be taken as the measure. The weight to be given to such cost figures and other items or classes of evidence is to be determined in the light of the facts of the case in hand."

We submit that the above statement of the law is at this date beyond question, and that the procedure of the Commission in the instant case was in exact conformity with it. Mature and deliberate consideration was given to every possible element of value, and the result was the reasoned opinion of the Commission.

Indeed, the Appellants hardly dispute this argument. In their brief, they say:

> "This Court has repeatedly held that present value is not synonymous with original cost, nor it is a matter of mathematical formula, but must be determined by a consideration of all relevant facts and circumstances" (brief, p. 49).
>
> "This Court has never held that value and cost of reproduction, less depreciation, if any, are synonymous. Appellants do not so contend. * * * It is, however, a relevant fact to which due consideration must be given" (brief, p. 50).

This is repeated at pages 64, 65. Again, they say:

> "The rule of *Smyth* v. *Ames*, is a flexible rule adaptable to the circumstances of each particular case as it arises" (brief, p. 67).
>
> "The law does not require the use of spot prices" (brief, p. 95).

Yet they argue:

> "The present value theory is supported by principle as well as by precedent" (brief, p. 82),

and

> "The investment theory is economically unsound and rests upon the illusion that the dollar is a fixed and unchanging standard of value" (brief, p. 83).

And again:

> "As appears on the face of the Report no unfavorable economic consequences are to be anticipated by adherence to the 'present value' theory" (brief, p. 90).

V.

The Commission had a broad discretion in weighing the various elements of value in evidence before it and in reaching a conclusion based thereon. This discretion will not be reviewed by the Courts and the order made by the Commission in the exercise of such discretion, is not invalid as made without due process.

This value is attacked on the ground that it is in violation of the prohibition against taking property without due process of law, that is, confiscatory. If the value has been found by the Commission in accordance with the terms of the statute by giving "due consideration of all the elements of value recognized by the law of the land for rate-making purposes", the value found must be in accordance with due process. The Commission in determining the value did consider all the elements of value recognized in valuation proceedings which were put in evidence, so that the precise objection to the finding is that due consideration was not accorded these various factors of value. What is due consideration of these elements? How much weight must each individual element receive? As shown

by Point IV of our brief, the law at the present time is only that the Commission must give due consideration to these various elements of value. This Court has refused to set up a definite standard of cost of reproduction or original cost. *Minnesota Rate Case*, 230 U. S., 352 at 450; *Willcox* v. *Consolidated Gas Co.*, 212 U. S., 19; *Smyth* v. *Ames, supra*. The standard of valuation for rate-making purposes as announced by this Court is a flexible one and was embodied in the very terms of the statute, "due consideration" of these various elements.

Unless this Court is willing to repudiate *Smyth* v. *Ames* and set up an absolute standard for value as was advocated in the dissenting opinion in *Southwestern Telephone* v. *Public Service Commission*, 262 U. S., 276, and by Appellants in this case, there must necessarily be a discretion in the administrative tribunal as to the weight to be given the various elements of value. For instance, some of the elements recognized in *Smyth* v. *Ames* and other cases may, after consideration, be given no weight. Good will and franchise value may be excluded from the rate base. *Cedar Rapids Gas Light Co.* v. *Cedar Rapids*, 223 U. S., 655 and 669 and *Des Moines Gas Company* v. *Des Moines*, 238 U. S., 153 at 165. The cost of developing the business as a financially successful concern may be excluded. *Galveston Electric Co.* v. *Galveston*, 258 U. S., 388. Earning power and capitalization as elements of value in determining the rate base may be disregarded by Commissions. The chief objection of Justice Brandeis as expressed in the dissent above referred to was that "what, if any, weight shall be given to any one (of these elements of value) must practically rest in the judicial discretion of the tribunal which makes the determination". In this field (of discretion), however large or small that may be, the Court will not substitute its judgment for that of the Commission, where that judgment

is supported by substantial evidence. Such has always been the law with respect to orders of the Interstate Commerce Commission where questions substantially important and complex were involved.

The Assigned Car Cases, 274 U. S., 564;
The New England Divisions Case, 261 U. S., 184;
C. R. I. & P. Ry. v. U. S., 274 U. S., 29.

The rule of *Smyth* v. *Ames* being that due consideration must be given to all the elements of value in settling a rate base, it is clear that the weight to be given these various factors must be in the discretion of the Commission. Therefore, unless the evidence compels conviction that a fair minded Commission could not have reached the conclusion that the value which the Commission found for the O'Fallon was fair, that value should not be set aside.

Such was the effect of the following cases, where it was held that a rate order will not be set aside unless the evidence compels conviction that a fair minded board could not have reached the conclusion that the rate would prove adequate.

San Diego Land & Town Co. v. *National City*, 174 U. S., 739, page 754;
San Diego Land & Town Co. v. *Jasper*, 189 U. S., 439, at 442;
Knoxville v. *Knoxville Water Co.*, 212 U. S., 1 at 17;
Van Dyke v. *Geary*, 244 U. S., 39 at 49;
Galveston v. *Galveston*, 258 U. S., 388 at 401 and 402.

The valuation of the Commission is also attacked on the ground that it is arbitrary and unreasonable. If the

order was supported by substantial evidence, this contention disappears with that mentioned above. It is submitted that the opinion of the Interstate Commerce Commission in the record discloses substantial evidence to support its finding. The fairness and propriety of the reasoning by which the conclusion of ultimate fact, that is, value, was reached, is also disclosed in that opinion and in the opinion given in the *Texas Midland case*. This Court has repeatedly held that it would not substitute its reasoning for that of the Commission and will not inquire whether it would have reached the same ultimate conclusion of fact from the evidence before the Commission.

> "It is not for the courts to weigh the evidence before the Commission, * * *; or to enquire into the soundness of the reasoning by which its conclusions are reached, * * *; or to question the wisdom of regulations it prescribes. * * * These are matters left by Congress to the administrative 'tribunal appointed by law and informed by experience.'"
>
> *Assigned Car Cases*, 274 U. S., 564, at 580-581.

Therefore, since the finding of value by the Commission was supported by evidence upon which a fair minded body could reach that conclusion, this Court will not disturb it.

VI.

The action of the Commission in rejecting the spot cost of reproduction as the sole basis of valuation in the recapture years was in conformity with the intention of Congress in framing the Transportation Act of 1920.

The history of the legislation is helpful in its interpretation. This Court in a measure reviewed it in the *Wisconsin Passenger Case* cited *infra*, page 84.

Prior to the entrance of the United States into the World War, the railroads of this country were in a very serious financial condition. Fears were widely expressed that they were in imminent danger of bankruptcy unless rates were increased and consolidations permitted. That these fears were justified became evident when the Government took over control and management of the railroads in December, 1917. The whole transportation system was crippled for lack of funds. In order to place the railroads in operating condition, it was necessary for the Government to expend enormous sums for new equipment and repairs to the existing facilities.

There ensued hearings before a Special Committee of Congress to determine the maximum compensation to be awarded the railroads for the use of their lines. The amount of the awards was determined by reference to the percentage of operating profit for the three year period to July 1, 1917, on the basis of the investment account or book value of the lines taken over. This percentage was found to be 5.2 per cent. At the hearings, counsel for the railways contended that this percentage should not be applied to the book value as of 1917, but to the book value as of January 1, 1918, which was the time the government actually took over the lines. The difference between the

book value as of July, 1917 and January 1, 1918 was about a billion dollars. The percentage was finally applied to this larger figure of about nineteen billion, so that the compensation paid by the government was on the basis 5.2 per cent. of nineteen billion, or about $900,000,000 for the roads actually operated.

The general opinion in both the House and Senate was that this rental was too high, because it had been based on an inflated book value.

As soon as the Armistice was signed and the actual state of war ceased, the President signified his desire to return the railroads to private control. The owners, who had been enjoying the high financial return from the government rent, became greatly concerned, as the stocks and bonds depreciated to such an extent that the market value of all the railroad securities was less than twelve billion dollars. In this crisis, hearings were had before a combined Senate and House Committee on Interstate Commerce.

Representatives of substantially all the railroads agreed that unless some favorable legislation was adopted, the return of the property to private control would be followed by general bankruptcy and ruin. The Savings Banks and Life Insurance Companies, as holders of enormous amounts of railway securities, presented plans for Congressional action. Every remedy, from the continuation of government control to returning the property without any legislation, was suggested to this committee. It was agreed by most people that if the railroads were to be operated under private control successfully, certain things were necessary. It was imperative that the railroad securities be stabilized, and that the rate of return be sufficient to attract capital. The plan must provide some guaranty of income for the immediate future in

order to prevent utter collapse of credit. The United States must allow the railroads ten years or more to fund the six hundred to a thousand million dollars due the government for capital investments and improvements. The plan must provide for immediate loans by the government to enable the railways to get started. Unless Congress could be induced to enact legislation containing such provisions, the owners of the roads and the ardent proponents of private control were agreed that government operation or ownership was the only alternative.

It is significant, then, that the Transportation Act as finally enacted, embodied substantially all the guaranties of income and aids to private ownership requested by the railroad executives and the security holders.

Congress extended its credit to the railroads, and gave an absolute guaranty of a fair return for a short period and provided a scheme of rate-making which would result in securing a fair return to all carriers. It should be remembered, Congress was under no legal or moral obligation to grant the railroads all these concessions—but did so in order to enable them to establish a self sustaining, efficient system of transportation—something which they could not have done without the assistance lent by this legislation.

The whole transaction constituted a species of "partnership" arrangement between the United States and the railroads in order to establish and maintain a successful transportation system under private operation. That this arrangement has been extremely beneficial to the railroads is evident and acknowledged. The Government, by giving financial assistance, by removing the railroads from the operation of the Anti-Trust Acts and other restrictive legislation, by its supervision of securities, by its limitation on competition and construction, and by giving the

Commission for the first time, direct power to remove "any undue, unreasonable or unjust discrimination against interstate or foreign commerce," whether made by State authority, or otherwise, has placed the railroads in the best financial position they have ever enjoyed.

One of the basic factors in this legislation was the matter of rates. It was the opinion of the Senate Committee that a certain percentage should be declared a fair return and that rates should be fixed with a view of securing such return to the railways. That provision immediately brought up the question, which had been raised previously under the Federal Control Bill—What is the value of the property on which this percentage shall be figured?

The plan submitted by the railroads provided for rates sufficient to render a fair return on their book value. But the book value of about nineteen billion was generally considered so high and inaccurate that it would be unfair to the public to adopt it. A reference to the debates will show that there was great opposition to providing for a basis of book value. The question was asked time and time again, if the book value is too high, what value will be taken? In answer to this, it was said, the rate base would be the valuation which the Interstate Commerce Commission would set, based on its preliminary findings under the Hepburn-Dolliver Act. Even the enemies of the bill could only assert that this would probably mean that book value would be taken until the final valuations were found under Section 19a.

This point of valuation was one of the decisive points of controversy in both houses of Congress, and it is safe to assume that the bill would never have been passed, had not both the Senate and the House been assured that the actual value of the railroads for rate-making would not exceed the book value of nineteen billion dollars. It

is apparent from the debates, also, that both Houses assumed that the fair value would be less than book value.

At that time "spot reproduction cost" was at least forty billion.

Congressman Esch, reporting and explaining the final draft bill out of the Conference Committee of the two houses, Cong. Rec. Vo. 59, Pt. 4, page 3269, said:

> "Investors want something definite and fixed upon which they can reckon. The provisions of section 422 (15a) give that stability, that standard which, I trust, will encourage investment; but it is objected that we are making a standard based on the rate of return on the value of the property. What is the value of the property? For the present I acknowledge we have not yet available the physical valuation as prescribed by the act of 1913, but much information is already available to the commission secured under this act. Under section 422 the commission, in determining the aggregate value, shall give to the property investment account only such consideration as is allowed under the law of the land. We do not make capitalization —please mark this—we do not make capitalization the basis of valuation. It may amount to something, or it may amount to nothing. It is only one of the elements which the commission prior to the completion of the valuation work shall consider as laid down by the Supreme Court of the United States in the leading case of Smythe against Ames, One hundred and sixty-ninth United States Reports, opinion by Harlan, justice. What the valuation made by the commission will be I can not state. It will not be property investment account or the book cost, now estimated to be about $19,000,000,000, for everybody knows that book cost or property investment account

exceeds the capitalization. Prior to 1907, when the uniform system of accounting was prescribed, these property investment accounts were no doubt padded, but since that time every dollar invested in railroad property is accounted for and can be found in the records of the Interstate Commerce Commission. It may be said, therefore, that neither the property investment account nor the capitalization will be the permanent standard of valuation. But the standard will be such as the commission will fix in the light of the information it already has and will secure as the result of the physical valuation act of 1913."

Substantially similar statements appear frequently throughout the debates and there are many actual expression that the value of the property as finally found would be under the book value.

It will be seen from this quotation that by the word "value" as used in the Act was meant value as found in the application of the rule announced in *Smyth* v. *Ames;* and that when the Act provided that value shall be found according to the law of the land, it meant value shall be found according to "Smythe against Ames." Further, Mr. Esch and the other members of the Committee had listened for months to counsel for the carriers and security holders expound the law, so that if "spot reproduction cost" were then considered by the railroad owners as the dominant measure of value according to the "law of the land," they would have been well informed of it.

This statement and others like it were also induced by the fact that the railroads themselves had proposed a bill in which it was provided that book value alone should be the basis of rates. Certainly Congress could assume that the railroads would not underestimate the value of their prop-

erty, especially since this book value was everywhere regarded as so high and inaccurate that it would be unjust to the public to adopt it.

As further evidence of the conception of value on which this "partnership" was consummated, it is only necessary to look at the statements of the officers of the railways made in 1919 and 1920 under various circumstances. The value which these officers placed on the railroad property, even in their million dollar advertising campaign to educate the public in that respect, was never more than twenty-five billion dollars. What the railroads really wanted and all that they seriously requested was a valuation sufficient to enable them to attract private capital.

The statement of Mr. Esch and others referred to, show that Congress assumed that the value found under the Hepburn-Dolliver Act would according to *Smyth* v. *Ames* be less than the book value. The very fact that Section 15a provides for the use of the final figure substantiates this conclusion.

The Hepburn Dolliver Act (19a), the Transportation Act of 1920 (15a), the debates in Congress concerning this legislation, all show that Congress assumed that one basic valuation of the property could be made, which would be changed only by additional capital investments or depreciation. It was further assumed that these additional capital investments, being supervised by the Interstate Commerce Commission, would be added as a set sum, so that the fair value of the property would never be in doubt again.

That every one of these assumptions and conceptions were unfounded and erroneous if reproduction cost is the sole or even the dominant measure of value, is evident, for in 1920, when the fair value was everywhere stated and considered as less than the book value of nineteen billion dollars, "spot" reproduction of the property would

have required at least forty billion dollars; and the changing nature of the "reproduction cost" is not consistent with any fixed valuation of the present property or additional capital investments.

The facts set forth in this point are so largely current history and matters of common knowledge, that we have, for the sake of brevity, omitted specific reference to original sources supporting each statement, especially since the opinions of this Court in previous cases have shown a complete familiarity with practically all the facts mentioned. For the convenience of the Court, however, we list the following as the more important of such sources: Reports of hearings before the Special Committee on Interstate Commerce in 1916; The Congressional Record, Volumes 58 and 59 (especially Vol. 59, Parts I, III, and IX); and the files of The New York Times, The New York Tribune, and the Financial Chronicle during 1919 and 1920.

VII.

Appellants in effect attack the whole 1920 scheme of legislation, first by urging a construction which would make it impracticable, and secondly by challenging its constitutionality. This Court has broadly upheld the constitutionality of the Act in all the cases which have involved its consideration. The application of the recapture clause invades no constitutional rights of Appellants.

The question raised in this case is not an ordinary one of evaluation of property devoted to public use, but rather whether the new policy of the Act of 1920 can be carried out and the general railroad transportation system of the country be treated as a whole pursuant to the Act and rates fixed on the basis of fair value, yielding returns

which result in a stable and general prosperity such as the railways never before have known, or whether the Constitutional provision against taxing property without "due process" requires annual valuation of the property of every railroad on the basis of the estimated cost of its new construction at that time and at the prices for material and labor then obtaining. In a word, the issues in this cause, in effect, involve the constitutional practicability of the entire scheme of the 1920 legislation.

In all the cases which have brought this legislation before this Court, its great important and the vast public interest involved in giving it a broad and sympathetic construction have been recognized and full effect allowed to its provisions. Section 15a has been considered in four decisions:

Railroad Commission of Wisconsin v. *C. B. & Q. R. R. Co.*, 257 U. S., 563;
New York v. *United States*, 257 U. S., 591;
New England Divisions Case, 261 U. S., 184;
Dayton-Goose Creek Ry. v. *U. S.*, 263 U. S., 456.

Railroad Commission of Wisconsin v. *C. B. & Q. R. R. Co.*, 257 U. S., 563, known as the *Wisconsin Passenger Fares Case*, arose out of an investigation begun and carried on by the Commission under paragraphs (3) and (4) of Section 12 of the Commerce Act, as amended by the Transportation Act of 1920, Section 416, into alleged undue and unreasonable discrimination against interstate commerce arising out of intra-state railroad rates in Wisconsin. The Commission had investigated the interstate rates of carriers in the United States in a proceeding known as *Ex Parte 74, Increased Rates*, 58 I. C. C., 220, for the purpose of complying with Section 15a of the Commerce Act (Section 422, Transportation Act of 1920), and

had ordered an increase for the carriers in the group of which the Wisconsin carriers were a part, of 35% in interstate freight rates, and 20% in passenger rates and excess baggage charges, and a surcharge upon passengers in sleeping cars amounting to 50% of the charge for space in such cars to accrue to the rail carriers. Thereupon, the carriers applied to the Wisconsin Railroad Commission for corresponding increases in intrastate rates. The State Commission granted increases in intrastate freight rates of 35%, but denied increases in intrastate passenger fares and charges, on the sole ground that the State statute prescribed a maximum for passengers of two cents a mile. The Interstate Commission investigated the facts, and found that the State action constituted undue, unreasonable and unjust discrimination against persons travelling in interstate commerce and against interstate commerce as a whole. It therefore ordered that the undue discrimination should be removed by increases in all intrastate passenger fares and excess baggage charges and by surcharges corresponding with the increases and surcharges ordered in their interstate business. The carriers filed these bills in equity in the District Court to enjoin the State Railroad Commission and other State officials from interfering with the maintenance of the fares thus ordered and published. An interlocutory injunction was granted by the District Court, from which appeal was taken to the Supreme Court, where the order was affirmed by an unanimous Court (Taft, C. J., writing the opinion), upon the ground that the amendments to the Commerce Act in the Transportation Act of 1920 for the first time vested the Commission with the direct power to remove "any undue, unreasonable or unjust discrimination against interstate or foreign commerce"; that if the provisions and purpose of Section 15a are interfered with by a disparity of intra-

state rates, the Commission is authorized to end the disparity by directly removing it, because it is plainly an "undue, unreasonable or unjust discrimination against interstate or foreign commerce" within the ordinary meaning of those words.

The Court reviewed the history of the new legislation of 1920, referring to the fact that

> "the most novel and most important feature of the act requires the Commission so to prescribe rates as to enable the carriers, as a whole or in groups selected by the Commission, to earn an aggregate annual net railway operating income equal to a fair return on the aggregate value of the railway property used in transportation. For two years the return is to be 5½%, with one-half per cent. for improvements, and thereafter is to be fixed by the Commission.
>
> "The act sought to avoid excessive incomes accruing under the operation of §15a to the carriers better circumstanced, by using the excess for loans to the others, and for other purposes. * * *" (pp. 584-5).

The opinion showed that the Act made a new departure; that theretofore the control which Congress, through the Commission, exercised, was primarily for the purpose of preventing injustice by unreasonable or discriminatory rates against persons and localities, and the only provisions of law that enured to the benefit of the carriers were the requirements that the rates should be reasonable in the sense of furnishing an adequate compensation for the particular service rendered, and the abolition of rebates.

> "The new measure imposed an affirmative duty on the Interstate Commerce Commission to fix rates and to take other important steps to maintain an adequate railway service for the people of the United States.

> This is expressly declared in §15a to be one of the purposes of the bill."

The Court further referred to the fact that while counsel for the Appellants had not contested the constitutional validity of the statute, construed as the Court construed it, counsel for the State Commissions, who filed briefs as amici curiae, had done so. The Court said:

> "The principles laid down by this court in the *Minnesota Rate Case*, 230 U. S., 352, 432, 433, the *Shreveport Case*, 234 U. S., 342, 351, and the *Illinois Central Case*, 245 U. S., 493, 506, which are rate cases, and in the analogous cases of *Baltimore & Ohio R. R. Co.* v. *Interstate Commerce Commission*, 221 U. S., 612, 618; *Southern Ry. Co.* v. *United States*, 222 U. S., 20, 26, 27; *Second Employers' Liability Cases*, 223 U. S., 1, 48, 51, we think, leave no room for discussion on this point. Congress in its control of its interstate commerce system is seeking in the Transportation Act to make the system adequate to the needs of the country by securing for it a reasonable compensatory return for all the work it does. The States are seeking to use that same system for intrastate traffic. That entails large duties and expenditures on the interstate commerce system, which may burden it unless compensation is received for the intrastate business reasonably proportionate to that for the interstate business. Congress as the dominant controller of interstate commerce may, therefore, restrain undue limitation of the earning power of the interstate commerce system in doing state work" (pp. 589-590).

The same principle was applied in the following case of *New York* v. *United States*, 257 U. S., 591.

The Act again came before this Court in the *New England Divisions Case*, 261 U. S., 184, which arose on an appeal from a decree of the District Court refusing an interlocutory injunction against the Commission in a suit to set aside its order directing, in substance, that the divisions or shares of the several New England railroads in the joint through freight rates between that section and the rest of the United States, which joint rates had just been increased pursuant to order entered in *Ex Parte 74, Increased Rates*, 58 I. C. C., 220, be readjusted, upon the ground that its purpose was not to establish divisions just, reasonable and equitable as between connecting carriers, but, in the public interest, to relieve the financial needs of the New England lines so as to keep them in effective operation. The order of the Commission was sustained under the authority of Section 418 of the Transportation Act of 1920, amending the Interstate Commerce Act, Section 15, paragraph (6), the Court holding that this Act had introduced into the Federal legislation a new railroad policy.

> "Theretofore, the effort of Congress had been directed mainly to the prevention of abuses; particularly, those arising from excessive or discriminatory rates. The 1920 Act sought to ensure, also, adequate transportation service. That such was its purpose, Congress did not leave to inference. * * * And to attain it, new rights, new obligations, new machinery, were created. The new provisions took a wide range. Prominent among them are those specially designed to secure a fair return on capital devoted to the transportation service. Upon the Commission new powers were conferred and new duties were imposed" (pp. 189-190).

Pointing out the condition of the carriers at the close of the war; that it was deemed important to preserve for the nation substantially the whole transportation system, but that large sums were needed, not only for improvement and expansion of facilities, but for adequate maintenance; that a general increase alone would not meet the situation; there was a limit to what the traffic would bear; that a 5% increase had been granted in 1914; 15% in 1917; 25% in 1918; that it was not clear that the people would tolerate greatly increased rates, although no higher than necessary to produce the required revenue of weak lines, if thereby prosperous competitors earned an unreasonably large return upon the value of their properties; that the varying needs of the several lines and their widely varied earning power was fully realized, the Court said it was necessary to avoid unduly burdensome rate increases, and yet to secure revenues adequate to satisfy the needs of the weak carriers; that

> "To accomplish this two new devices were adopted: the group system of rate making and the division of joint rates in the public interest" (p. 191).

The difficulties of applying either of these devices were pointed out.

> "Raising joint rates for the benefit of the weak carriers might be the only feasible method of obtaining currently the needed revenues. Local rates might already be so high that a further increase would kill the local traffic. The through joint rates might be so low that they could be raised without proving burdensome. On the other hand the revenues of connecting carriers might be ample; so that any increase of their earnings from joint rates would be unjustifiable. Where the through traffic would, under those circum-

stances, bear an increase of the joint rates, it might be proper to raise them, and give to the weak lines the whole of the resulting increase in revenue."

This, the Court said, might have been the condition with the New England lines. The extent of the Commission's power to deal with the situation was the subject of doubt, and the Transportation Act of 1920 undertook, by Section 15 (6), to remove doubts which had arisen, but Congress had also the purpose explained above. Construing the Act as authorizing such apportionment of the joint rate on the basis of the greater needs of particular carriers, the Court considered and upheld its constitutionality. It was noted that there was no claim that the apportionment resulted in confiscatory rates, nor was there in the record any basis for such contention.

> "The argument is that the division of a joint rate is essentially a partition of property; that the rate must be divided on the basis of the services rendered by the several carriers; that there is no difference between taking part of one's just share of a joint rate and taking from a carrier part of the cash in its treasury; and, thus, that apportionment according to needs is a taking of property without due process" (p. 195).

The Court said the argument begs the question. Its just share was the amount properly apportioned out of the joint rate, to be fixed by the Commission at what it found to be just, reasonable and equitable. It was a part of the rate-making power. There was no constitutional obstacle to the adoption of the method pursued. There was evidence before the Commission ample to support the order made.

"To consider the weight of the evidence, or the wisdom of the order entered, is beyond our province. *Manufacturers Ry. Co.* v. *United States*, 246 U. S., 457; *Skinner & Eddy Corporation* v. *United States*, 249 U. S., 557, 562; *Seaboard Air Line Ry. Co.* v. *United States*, 254 U. S., 57, 62" (p. 204).

In *Dayton-Goose Creek Ry.* v. *U. S.*, 263 U. S., 456, there was presented the question whether the so-called recapture provisions of the Transportation Act of 1920, Section 422, Section 15a, are constitutional. This was a proceeding to review the action of the Commission in determining the amount of surplus net operating income received by a carrier for the ten months of 1920 and the year 1921, under Section 15a. The unanimous opinion of the Court was delivered by the Chief Justice. The purposes of the Act were reviewed. It was held that

"The carrier owning and operating a railroad, however strong financially, however economical in its facilities, or favorably situated as to traffic, is not entitled as of constitutional right to more than a fair net operating income upon the value of its properties which are being devoted to transportation. By investment in a business dedicated to the public service the owner must recognize that, as compared with investment in private business, he can not expect either high or speculative dividends but that his obligation limits him to only fair or reasonable profit. If the company owned the only railroad engaged in transportation in a given section and was doing all the business, this would be clear. If it receives a fair return on its property, why should it make any difference that other and competing railroads in the same section are permitted to receive higher rates for a ser-

vice which it costs them more to render and from which they receive no better net return?" (p. 481).

The reduction of the net operating return provided by the recapture clause, it was stated, was as near as may be the same thing as if rates had all been reduced proportionately before collection.

> "It is clearly unsound to say that the net operating profit accruing from a whole rate structure is not relevant evidence in determining whether the sum of the rates is fair" (p. 483).

Answering the argument that the cutting down of income actually received by the carrier for its services to a so-called fair return is a plain appropriation of its property without any compensation, contrary to the Fifth Amendment, the Court said:

> "The statute declares the carrier to be only a trustee for the excess over a fair return received by it. Though in its possession, the excess never becomes its property and it accepts custody of the product of all the rates with this understanding. It is clear, therefore, that the carrier never has such a title to the excess as to render the recapture of it by the Government a taking without due process" (p. 484).

The Court further said:

> "The combination of uniform rates with the recapture clauses is necessary to the better development of the country's interstate transportation system as Congress has planned it. The control of the excess profit due to the level of the whole body of rates is the heart of the plan. To divide that excess and attempt to distribute one part to interstate traffic and

the other to intrastate traffic would be impracticable and defeat the plan. This renders indispensable the incidental control by Congress of that part of the excess possibly due to intrastate rates which if present is indistinguishable" (p. 485).

The instant case now presents a different side of the problem. The carriers are limited to "a fair return" on their properties. This fair return is upon the "fair value." The fixing of returns and values are based upon the consideration of the entire railway transportation system of the country, as a whole, or in groups fixed by the Commission. What this "fair value" is, upon which the entire legislative scheme depends, is shown under Points IV and V, *supra*.

VIII.

Appellants' argument when analyzed is in effect a contention that the Commission erred because it did not fix the value of the carrier's railway solely on the basis of cost of reproduction based on the prices prevailing at the recapture dates.

Despite their many protestations to the contrary (Brief, pp. 50, 64), the argument of Appellants, when analyzed, comes down to the contention that the Commission should have fixed the value of the O'Fallon's railway for each of the years in question, at the cost of reproduction (less depreciation) on the basis of the abnormal prices prevailing in each of the years of recapture. Any such rule would entirely destroy the whole basis of the legislation of 1920. It would substitute for the stability of railroad values which that legislation was enacted to secure, fluctuation and uncertainty, and probably would result in a recurrence of the conditions in railway investment which led to the

enactment of the Transportation Act, 1920. Valuation fixed according to any such rule would be fair neither to the railroads, to the shippers, nor to the public. Indeed in the same breath with their objection to the Commission's valuation, Appellants declare:

> "This Court has never said that value is synonymous with cost of reproduction. The appellants do not so contend" (Brief, p. 64).

They say it is, however,

> "* * * a relevant fact to be considered in connection with other relevant facts. It is the relevant fact which has most frequently been given controlling weight" (Brief, p. 64).

It may have been given controlling weight in many cases, but not in all. Nor do the decisions of this Court require it. The Commission in the instant case gave it consideration, but very properly refused to give it controlling weight, because of the unjust result it would have produced. They said in the Report:

> "It should not be forgotten that the value to be used as a rate base in the process of public regulation is only one element in the constitutional protection against confiscation of property. The other element is a 'fair return' upon such value. * * * Value rests on a number of elements" (Rec., pp. 72-75).

Nor it is correct to say, as do the Appellants, that

> "There is, therefore, no dispute * * * that, in pursuing this method, the Commission was endeavoring to arrive at the approximate investment in the property, in the absence of reliable information as to original cost" (Brief, p. 61).

if by that is meant that they were seeking to ascertain the amount of investment to give it controlling weight in valuing the property. The statute charged them with the duty of giving to the property investment account of the carriers only that consideration which under the law of the land it was entitled to for rate-making purposes.

The law of the land, as declared in *Smyth* v. *Ames*, and quoted in this brief at pages 54, 60, requires the consideration of many factors among which are "the original cost of construction, the amount expended in permanent improvements * * * the present as compared with the original cost of construction * * *." The Commission considered all these various elements, concluded that the cost of reproduction at the abnormal prices prevailing in 1920, 1921, 1922 and 1923 would not have been fair value for rate-making purposes; that the 1914 prices as a basis of fair value were fairer for everyone. From all the accumulated information bearing on the value of this property, the Commission reports:

> "We have formed our judgment as to the fair basic single-sum values, *not by the use of any formula*, but after consideration of all relevant facts." (Italics ours.) (Rec., p. 71.)

Appellants, in their Brief, say:

> "With commendable frankness the Commission has rested its findings of value upon the investment theory of public utility valuations" (Brief, p. 76).

With equal frankness, we must say that the Commission did nothing of the kind. In the Report, they say:

> "A system of valuation for rate-making purposes based on actual, legitimate investment would have

many appealing features * * *. But there are practical difficulties in the way of the adoption of such a system. * * * The methods which we have followed in determining the basic values of the older property have been described at length in our valuation reports under Section 19a. Briefly, we have had before us the cost of reproduction new of the structural portion of this property estimated on the basis of our 1914 unit prices, coupled with the knowledge that costs of reproduction so arrived at were not greatly different from the actual original costs. We have had complete information as to the depreciation of this property, in other words, as to that portion which in reality had ceased to exist because of the consumption of service life. We have had complete information as to the value of the railroad lands, based on the contemporaneous market values of adjoining and adjacent lands. We have had information, as complete as could be secured, relative to the financial and corporate history of the property, including its past earnings. We have further had such information as could be developed with reference to possible appreciation in the value of certain parts of the property because of better adaptability for use, and with reference to such other matters as the carriers desired to bring to our attention.

"From this accumulated information we have formed our judgment as to the fair basic single-sum values, *not by the use of any formula, but after consideration of all relevant facts.* In our opinion these judgments have been reasonably liberal to the carriers" (Rec., pp. 70-71). (Italics ours.)

Again, they say:

> "It has been suggested that while it may be going too far to take current cost of reproduction as the basic measure of value, some weight ought to be given to changes in general price levels. Under the method outlined above we do give weight to such changes in so far as they have been reflected in prices paid for new construction or replacements, and we value lands at their prevailing market values. We know of no other way of giving weight to this factor which is not dependent upon caprice, unless full weight be given under the current reproduction cost doctrine. • • • Since it is incumbent on us to ascertain the value of the property as of the time covered by the inquiry regarding net railway operating income, we conclude that in this instance we should state the value found as of December 31, 1920, 1921, 1922, and 1923, the end of each of the recapture periods now under consideration. We shall, however, make proper adjustments necessary to take into account the average changes in property during each of such periods" (Rec., p. 73).

Thereupon follows a statement of the facts bearing upon these various points, at the conclusion of which the Commission says:

> "Weighing the figures previously mentioned in the light of these considerations and the entire record, and viewing the carrier as a common carrier in successful operation and with an established business, we conclude that the value for rate-making purposes of the entire common carrier property of the O'Fallon on June 30, 1919, was $850,500" (Rec., p. 74).

The Report continues:

"It is urged on behalf of the O'Fallon, in effect, that the value of its property in 1914 was not less than the cost of reproducing it at prices then prevailing, and that its value in 1920 was at least its cost of reproduction at prices prevailing at that time. Our reasons for disapproving this doctrine have already been given at length, and even if the cost of reproduction new in 1920 were to be regarded as a controlling element, there is not in the present record evidence showing what it might have cost to reproduce the property of the O'Fallon at that time. The only evidence in this respect is that of the relation of general prices in 1914 and in 1920 and the other recapture years. • • • There is no testimony here as to how much it cost to build any railroad or any substantial part of one in any of the recapture periods, and for that reason it is impossible to make a comparison of such costs in the two periods. It is not safe to assume, as the O'Fallon has assumed, that costs of building railroads have varied in recent years in direct ratio to the variation in costs of commodities in general use, or in the costs of materials or labor generally.

The fallacy of basing reproduction cost upon price curves or ratios is clearly indicated by the tabulations introduced by the carrier" (Rec., pp. 74-75).

It is further stated in the Report:

"Value rests upon a number of elements. The value of the property of railroads for rate-making purposes, which is construed to be the value of property devoted to common-carrier purposes upon which common carriers are entitled under the law to earn a fair return, approaches more nearly the reasonable and necessary

investment in the property than the cost of reproducing it at a particular time" (Rec., p. 75).

This expression of opinion is seized upon by the Appellants to justify their argument that the Commission rested its findings of value upon the investment theory of public utility valuation. This contention has required somewhat fuller quotation from the actual Report of the Commission than would otherwise have been necessary.

Appellants devote a point in their brief to the argument that "the investment theory is unsound both in law and economics," (pp. 76, 83, et seq). It hardly seems necessary to devote so much space to something which is purely academic. We have already pointed out that the Commission did not adopt the investment theory as the basis of its decision. It expressed the views above quoted as to the superiority of the cost of investment as a rate base under present conditions, to a certain extent, over that of an attempt to fix reproduction cost. But the Report, and particularly the extracts above cited quite clearly demonstrate that the Commission did not adopt the amount of investment as the basis of its finding of value. Consequently, all of the argument which refers to this as "the Commission's theory" and predicates reasoning upon the assumption that the Commission fixed value on the basis of investment cost, is wholly irrelevant. This observation applies to a large part, if not all, of the argument under Appellant's Point VI.

We feel confident that a perusal of the Report of the Commission will demonstrate the error of the Appellants in the construction which they have put upon it, and upon which their argument is largely based.

In a word, the case of the Appellants, in the last analysis, rests entirely upon the contention that the Commission was bound to determine value for the purpose of en-

forcing the recapture provisions of Section 15a, paragraph 6, solely as the cost of reproducing the property in each of the recapture years at the prices then current. As we have shown under Point IV, this is not the rule of *Smyth* v. *Ames*, and never was the rule approved by this Court. It is particularly inapplicable in the present instance. The Transportation Act, 1920, introduced a new epoch in the relations between the Government and the railways. No longer was the fair valuation of the railways to be determined exclusively by the cost of reproducing each particular system. The railways as a whole throughout the country were to be considered. They were to be dealt with as a national system, or in groups, as the Commission should determine. Two controlling factors were to govern the valuation upon which rate-making should be based. One was a sufficient basis for fixing rates which would produce a compensation adequate, not only to meet current expenses and current obligations and provide a fair return upon invested capital, but also to be sufficiently attractive to investors to supply carriers with credit adequate to secure the needed capital for further development. The other was not to fix a value so high that the rates would be so burdensome to shippers as to lead to legislative reprisals and very much lower rates. It is quite obvious that under this legislation some basic date must be fixed as of which the railroad properties should be valued, and fluctuation of values from year to year thereafter dealt with by applying the result of changes in property acquisition or deprecaition. This the Commission has done. They are ascertaining the values of all the railroads in the country as of 1919 on the basis of the general level of prices in 1914. The Report states:

> "In more than 400 reports relating to the value of individual railroad properties we have said:

> "'The estimates of cost of reproduction covered by this report are based upon what is referred to herein as the 1914 level of prices, while the present values of the common-carrier lands covered by the report are based upon a fair average of the normal market value of land adjoining and adjacent to the rights of way, yards and terminals of the carrier as of valuation date. This discrepancy will be removed when the Commission adjusts to later dates, in accordance with the requirements of the Valuation Act, the final value herein reported'" (Rec., p. 72).

Referring to the contention that the current cost of reproduction doctrine must be applied, the Commission says:

> "The conception of a rate base and returns thereon fluctuating up and down with changes in the level of general prices is a conception which, if carried into actual operation, could have no appeal except to stock-market speculators. It would be difficult to conceive of any plan more conducive to the encouragement of unrestrained speculation in railroad shares than such a method of valuation. In all probability it would provide a feast superior to anything which the bulls and bears have enjoyed since the creation of stock exchanges. History demonstrates beyond question that the general price level is never stable, and that its future fluctuations are impossible of successful forecast" (Rec., p. 69).

Appellants complain that the order is void for errors of law because

> "the Commission's findings of so-called value were determined by the use of a mathematical formula, the avowed purpose of which was to determine the approximate investment in the property as distinguished from its present value" (Brief, p. 52).

The review which we have made of what the Commission really did shows, in the first place, that their action was not directed "to determine the approximate investment," but to ascertain the fair value of the property, using for that purpose all the elements prescribed by the rule in *Smyth* v. *Ames*. The Commission was charged by Congress with the duty of fixing the value of all the railroad property of the United States. They adopted for this purpose, not a formula, but a method. That method is described in the quotation from their Report given above (Rec., p. 72); that is, they endeavored to fix the present fair value by taking the cost of reproduction of the railroads as of 1919, based upon the unit prices of 1914. The report explains in detail the reasons for this action and the method followed in the instant cases.

They say:

> "Valuation counsel for Western carriers has urged us to dispose of this case by itself and upon its own merits. That is the correct procedure. * * * When, however, counsel goes further and suggests that in this case we shall not give consideration 'to what is to be done with the railroads of the country as a whole' we cannot assent. We are dealing with one small railroad. Nevertheless, what we do in this case we must in principle do for all the railroads in the United States. * * * There is here presented in reality a great national problem affecting public policy and welfare in a most profound way" (Rec., p. 60).

The whole Report shows that in reaching the valuation in this case, the Commission was not seeking a formula, but was bearing in mind the effect upon the valuation of the railroad property of the country as a whole of the methods they should pursue in this case in reaching the valuation upon which the recapture orders should be based.

No such mathematical process as that imagined by the Appellants was followed in arriving at the valuation fixed. By following the method described, the Commission exercised its judgment upon all the elements produced, and fixed a value which the Appellants vainly endeavor to show was the product of a formula. Appellants own argument is, in effect, that the Commission should have adopted a mathematical formula different from that which they say it did adopt, but, nevertheless, a formula, arrived at by taking the estimated cost of constructing the railroads new in each of the recapture years on the basis of the prices obtaining in those years.

IX.

The required payments by the O'Fallon are not confiscation. They leave to the company in each of the years affected a net railway operating income in excess of six per centum of the value of the railway property held for and used in the service of transportation, even on the basis of valuation contended for by the O'Fallon.

As Chief Justice Taft said in *Dayton-Goose Creek Ry. Co.* v. *United States*, 263 U. S., 456, a railroad has no constitutional right to earn more than six per cent on the value of its property. If, then, the O'Fallon earns nearly eight per cent on the highest valuation suggested as possible, how can any question of confiscation arise?

The amount contended for by the O'Fallon as a fair valuation is $1,350,000.00. The amount of the net earnings (undiminished by any deductions for the amount recaptured) was: For the last ten months of 1920, $147,519.89; for 1921, $182,726.73; for 1922, $165,123.47; for 1923, $169,103.98. The amounts of the excess over six per cent as calculated were, for the same periods: 1920, $106,755.96; for 1921, $130,205.13; for 1922, $106,391.03; for 1923, $110,409.22. Half of each such excess was ordered paid to the Commission. The amounts of such payments were: for 1920, $53,377.98; for 1921, $65,102.56; for $1922, $53,195.51; for 1923, $55,204.61. Subtracting the amounts of payments from the undiminished net operating income, we have the actual returns to the O'Fallon as follows: for 1920, $94,141.91; for 1921, $117,624.17; for 1922, $111,927.96; for 1923, $113,899.37. Assuming the value to be that contended for by the O'Fallon, $1,350,000.00, we find the percentage return to be: for 1920, 6.97%; for 1921, 8.71%; for 1922, 8.29%; for 1923, 8.43%. In all the periods except 1920, the return was more than

eight per cent; in 1920 it was very nearly seven per cent. In view of the fact that this Court has repeatedly found that six per cent was not confiscatory, and in view of the fact that the statute itself sets six per cent. as the return to which the carrier is entitled before recapture is to begin, it is clear beyond doubt that there has been no confiscation here.

Dayton-Goose Creek Ry. Co., supra.
Willcox v. *Consolidated Gas Co.*, 212 U. S., 19.
Des Moines Gas Co. v. *Des Moines*, 238 U. S., 153.

But Appellants claim that the total amount of the excess should be deducted before calculating the percentage, for, they contend, the restrictions placed on their use of their half of the excess income constitutes a taking of that share also, and the amount left to them, while six per cent on the Commission's valuation, is less than five per cent on their own valuation. Thus, they say, a question of confiscation is raised.

But Appellants themselves have strenuously contended that the statute imposes no trust on the company's half of the excess; that that is their own property (Appellant's Brief, pp. 39, 41, 168). They may keep it, have the legal title to it, use it for their own benefit, collect and spend the income from it. The only restriction placed upon it is that a portion of it shall be accumulated from year to year by setting aside one-half of the annual excess income until a fund of 5% upon the value of the railroad is reached, and that fund shall be used only *for the purposes of the carrier* as defined in the Act. The power of Congress to make such a regulation can hardly be considered arguable, and we do not propose to burden this Court with a review of the authorities. We only point out that the regulation is slight, really con-

cerning a matter of accounting and requiring only the establishment of a fund which good business practice should lead the railroad to establish voluntarily. It is exactly analogous to the undoubted power of commissions (under legislative authority) to impose sinking fund requirements, depreciation accounts, and generally to supervise accounting.

But this discussion is, after all, quite unnecessary, for this Court has already passed upon this very question, raised with regard to the section of the Act now under consideration. The same point, namely, that net revenue is obtained by deducting only the half of the excess income to be paid to the Commission, was made by Chief Justice Taft in the *Dayton-Goose Creek* case, under a similar set of facts. He said:

> "Here we are relieved from considering the line between a fair return and confiscation, because under the provisions of the act and the reports made by the appellant the return which it will receive after paying one-half the excess to the Commission will be about eight per cent on the reported value. This can hardly be called confiscatory" (p. 486).

This statement (which is incidentally a decision that the provision is constitutional), is exactly applicable to the situation in this O'Fallon case, and was so regarded by the District Court. The contention of Appellants is therefore not only untenable on principle, but directly contrary to the decision of this Court in the *Dayton-Goose Creek* case. With this contention removed, there is no constitutional question of confiscation in the case.

X.

The provisions of Section 15a, paragraph (6) so far as the income of the appellant companies is concerned took effect from and after the passage of the Act. Appellants contention that the recapture provision could not be applied to either of them until the results of the whole rate structure established by the Commission should realize the Congressional intention is unsupported by the Statute itself or by reason.

Appellants argue under their Point IX that under the proper construction of Section 15a, no excess earnings of a carrier are recapturable pursuant to paragraph (6) unless and until the Commission shall have fixed a general level of rates such as to yield a fair return upon the aggregate value of all railroad property with the use of the recapture clause as a check upon excessive earnings thereunder. This, they contend, the Commission has not yet done:

> "Looking at the country as a whole, there has not been substantial compliance with the Act on the part of the Commission. • • • The Commission has not completed its valuation work and has issued but few final valuations. • • • Under these circumstances it is respectfully submitted that there may be no recapture until it shall clearly appear that there has been substantial compliance with the rate making provision" (Appellants Brief, pp. 162, 166).

But Section 15*a*, we submit, warrants no such interpretation. Congress sought to accomplish a definite result. For that purpose it directed the Commission to do certain things. They were to make a tentative valuation of rail-

way property and to fix rates so as to produce 5½% to 6% on such value. They were to be readjusted from time to time. If in any year a carrier received more than 6% on such value paragraph (6) applied. To hold that there was no obligation to observe the requirements of that section until it should be established that the rate structure resulted in the general results anticipated, would be to reduce the Act to an absurdity. Congress had no such intention. The Act itself clearly shows that its provisions were to take effect at once. The exception expressed in the proviso in paragraph (3) that during the two years beginning March 1, 1920, the Commission shall take as such "fair return" (i. e., that which results from rates initiated, modified, established or adjusted by the Commission so as to realize a fair return upon the aggregate value of the railroad property of the carriers as a whole, or in rate groups or territories designated by the Commission) 5½% of such aggregate value, is clear proof of the intention that the Act should take effect at once. Congress was well aware that the Commission had been engaged since the passage of the Act of 1913 in making valuations of the property of the railroads, and that that work had not been completed. Therefore, in paragraph (4) of Section 15a, it was enacted that the Commission might utilize the results of its investigation under Section 19a insofar as deemed by it available, and that whenever, pursuant to Section 19a, the value of the railway property of a carrier had been finally ascertained, that value should be deemed by the Commission to be the value thereof for the purposes of determining the aggregate value according to that paragraph. Again, in paragraph (6) after the phraseology upon which Appellants lay such stress, and upon which they base the argument under Point IX there is a clause to the effect that in the case of a carrier which has accepted the provisions of Section 209 of the amendatory

act, the provisions of this paragraph (6) shall not be applicable to income for any period prior to September 1, 1920—a clause which would be meaningless unless as to other carriers the paragraph took effect immediately upon the approval of the Act of which it is a part and applied to income for the period commencing at that date. The report in the case of *Increased Rates, 1920 (Ex Parte 74)*, 58 I. C. C., 220, shows that compliance was made by the Commission with all of the requirements of Section 15 paragraph (6), of the Act. It appeared there that the railroad carriers sought authority, pursuant to the provisions of that Act, to increase their freight revenues to a basis which would enable them to earn an aggregate annual net railway operating income equal as nearly as may be to 6% upon the aggregate value of the railway property of such carriers held for and used in the service of transportation, and that after hearings, the Commission for that purpose divided the carriers among four groups, the railways of the Appellants falling within the Western group. The Commission then, using the evidence in its possession, and

> "from a consideration of all the facts and matters of record, and those which, under section 15a of the interstate commerce act, we are both required and authorized to consider" (p. 229),

found the value of the steam railway property of the carriers subject to the Act held for and used in the service of transportation; those in the Western Group amounting in the aggregate to $8,100,000,000 and for the entire country $18,900,000,000. The Commission thereupon proceeded to establish rates which might in the aggregate yield as nearly as might be 6% upon such appraised values until March 1, 1922.

Whether or not those rates in general have resulted in securing to all the carrier's the results aimed at in the legislation of 1929, is quite irrelevant to this case. It cannot be tried out in this proceeding. They have enabled the O'Fallon Railway to earn in the years involved upon its outstanding stock and bond issues; in 1920, 12.25%, 1921, 15.29%, 1922, 15.33% and 1923, 14.81%. They have resulted in the O'Fallon earning percentages in excess of 6% even of its own claimed valuation.

As a result of this legislation and the administrative action of the Commission, the Report makes the following statement, which cannot be disputed:

> "As stated above, during the period 1920-1926, inclusive, the investment in railroad property increased by 4 billions of dollars. A substantial part of this money was derived from income, but much of it was obtained by the sale of new securities. The market for railroad securities since the passage of the transportation act, 1920, has steadily improved and the general trend of interest rates has been downward. The credit of the railroads in general is now excellent, and the time seems to be approaching rapidly when many of them will be able to finance not only through bonds and notes but by issues of new stock. Already some of them are financing their needs in this way. • • • It is a matter of common knowledge that the increase in aggregate market values (of railroad securities) since 1920 has been very great" (Rec., p. 67).

XI.

The District Court erred in holding that the Commission exceeded its power in directing the payment of interest on the sums which it found were payable by the O'Fallon.

Paragraph (6) of Section 15a of the Transportation Act provides:

> "If, under the provisions of this Section, any carrier receives for any year a net railway operating income in excess of 6 per centum of the value of the railway property held for and used by it in the service of transportation, one-half of such excess shall be placed in a reserve fund established and maintained by such carrier, and the remaining one-half thereof shall, *within the first four months following the close of the period for which such computation is made*, be recoverable by and paid to the Commission for the purpose of establishing and maintaining a general railroad contingent fund as hereinafter described" (Italics ours.)

Paragraph (9) of the same section provides:

> "The Commission shall prescribe rules and regulations for the determination and recovery of the excess income payable to it under this section, • • •."

In pursuance of these provisions of the statute, the Commission adopted the following rule:

> "Interest on amounts of excess railway operating income payable to the United States under the provisions of Section 15a will be required at the rate of 6 per cent per annum, beginning four months after the

termination of the period for which the said excess income is computed" (Rec., p. 78).

It is submitted that the Commission was specially authorized to make such a rule, and that its action in so doing was not arbitrary or unreasonable, but in strict conformity to the unquestioned principles of law governing such situations.

The general rule with regard to the charging of interest against delinquent trustees is stated at 39 Cyc., 427, as follows:

> "The time from which interest is to be charged varies according to circumstances. Interest ought not, as a rule, to be required of a trustee before he actually receives the fund; nor should he be charged with interest from the date of the receipt of the trust moneys, *but only from a reasonable time thereafter, except where he appropriates them to his own use or mingles them with his own money, in which case interest may be charged from the date of the receipt.*"

This case comes within this exact language: the O'Fallon has been in possession, since the end of each respective recapture period, of a sum of money which the statute declared it held as trustee for the United States. In *Dayton-Goose Creek R. Co. v. U. S.*, 263 U. S., 456, the Court held that this provision was constitutional, and that the carrier held this sum of money, not as its own property, but as trustee for the government. In fact, it was distinctly stated in that case that the carrier never had such property in the money to be paid over to the government, that it could be "taken" within the meaning of the Fifth Amendment. It is not denied that the O'Fallon in this case has kept the money, mingled it with its other

funds, collected and enjoyed the income from it, and in all ways treated it as its own. The Commission did not attempt to charge the trustee for interest before it actually received the funds, nor even from the time it received them. It allowed the statutory period of four months as the reasonable time after the receipt of the funds from which the interest should be charged, in conformity to the general rule quoted above. Why, then, under the general rule as stated above, should the O'Fallon not pay interest?

It is contended that the O'Fallon maintained this action, and refused payment of the amount due, in the *bona fide* belief that it had a perfect legal right to do so, that the large amount of interest is due to the failure of the Commission promptly to prosecute measures for its recovery, and that it is therefore unjust to penalize the O'Fallon by the charging of a large amount of interest. The fallacy of this argument is immediately obvious. The O'Fallon is not being punished, or penalized; it is suffering no damage. The money was never its property; it has had possession of it for from five to eight years; has collected the income on it for that period, and has had the benefit of its use. Why should it now object to returning to the government the value of something to which it never had any right, that is, the use of the money? Not to allow the interest charged would be to allow the O'Fallon the use of government moneys for eight years without the payment of a cent of interest.

It has been argued that the sum on which the interest was to be calculated was never liquidated, and that it is improper to allow interest on unliquidated sums. It is submitted that this argument is wholly irrelevant, because it is an argument applicable to a recovery of a sum of money as damages, either for a tort or in contract. This is no such case, but one in which the money was *never* the property of the O'Fallon. It was *always* the property

of the government, and the government is only seeking to recover what was always its right, that is, the value of the use of the property, which the O'Fallon wrongfully enjoyed as trustee. To hold that a trustee may keep as his own the income from trust property, simply because he has in good faith disputed the amount of the *trust res*, is a doctrine so contrary to all principle that no further demonstration of its untenability is necessary.

We do not need to consider its effect in the general field of trusts. Its effect in this narrow field would be disastrous enough. It is safe to say that if the Commission is not allowed to recover the income from these trusts from the date of their establishment, it will never recover any of the *res* of the trusts without exhaustion of its legal remedies of enforcement. It will make for procrastination and delay any litigation, and very materially weaken the effect of the whole statute.

This discussion would seem to be a sufficient answer to Appellants' contention that no interest whatever should be allowed even from the date of the Commission's order, but we might observe that from and after the date of the order the sum directed to be paid would be liquidated, and not even an argument based on the fact that the amount of the trust fund was uncertain would be open to Appellants.

It is submitted that, on every consideration of principle and policy, the interest as fixed by the order of the Commission should be allowed.

CONCLUSION.

On the whole case, it is respectfully submitted that the decree of the District Court should be modified by reversing so much thereof as changed the order of the Commission concerning the payment of interest, and as thus modified, affirmed.

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